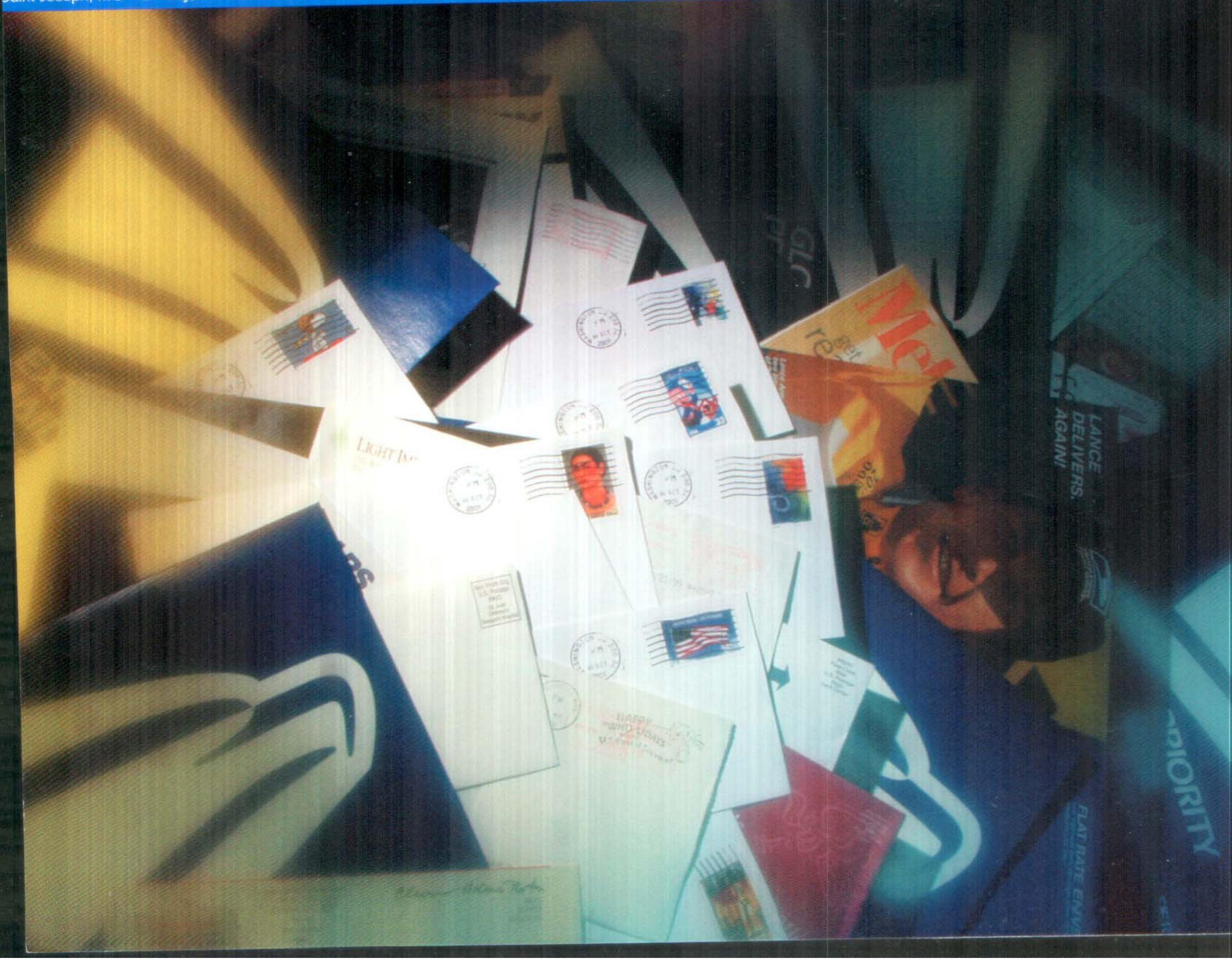
everyone everywhere every day

Credit union - Dance teacher - House cleaning service - Import business - Poultry farmer - Video rental - Wardrobe consulting - Press secretary - Music instruction - Nephew - Hote

Saint Joseph, MO - Oil City, PA - Kiawah Island, SC - Plattsburg, NY - Wahiawa, HI - Concord, NH - Bogalusa, LA - Rawlins, WY - Portage, ME - Worcester, MA - Odessa, DE - S



ns - Pastor - Veterinarian - Warehouse - Drama coach - Editorial service - Hauling service - Accountant - Linen supply - U.S. Marine - Tuxedo rental - Foreign language tutor -

The United States Postal Service delivers billions of pieces of mail, to millions of Americans, hundreds of days of the year | to moms, cowboys, surfers, daughters, grocery stores, firehouses, country homes, ccountants, museums, rock stars, politicians | they get birthday cards, IRS returns, college acceptances, lothes, magazines | from grandmas, auto dealers, food wholesalers, internet sites, schools, boat retailers, music tores, supermarkets, restaurants, airlines, florists, dads, theaters, bagel shops | they get birth announcements, ondolences, bills, lottery winnings, flyers, catalogs | from granddads, laboratories, caterers, ministers,

- Williamsburg, VA - Winnemucca, NV - Shelby, MI - Los Angeles, CA - Memphis, TN - Guymon, OK - Riddle, ID - Wenatchee, WA - Loveland, CO - Marathon, FL - Cincinnati, OH

ymnasiums, gas stations, photographers, telecommunications companies | to baseball players, repairmen, welers, barbers, carpenters, actors, chefs, doctors, joggers, painters, boxers, priests, graphic designers | they et invoices, advertisements, payment confirmations, greetings| from limo services, podiatrists, plumbers

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How to Read Our Financial Statements

How to Read our Annual Report

Have four minutes? We'll give you our world.

Some researchers say that shareholders spend an average of four minutes reading an annual report. We hope that you'll be able to spend more time than that with this year's Annual Report of the United States Postal Service. Delivering almost 208 billion pieces of mail to more than 136 million delivery addresses a year is a big job. It takes a lot of information to tell that story.

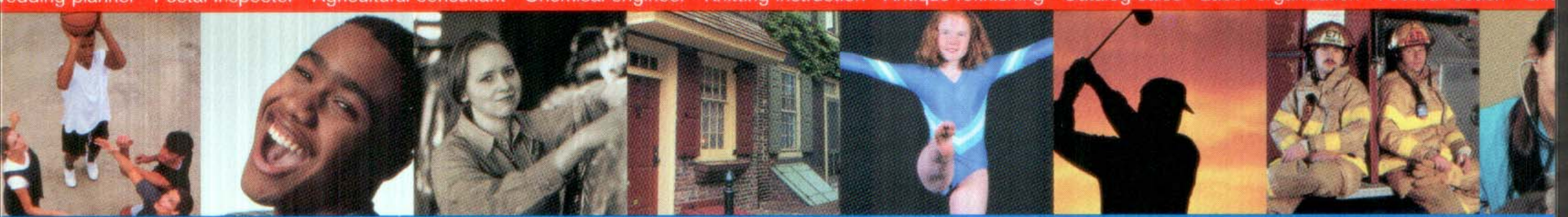
Either way, we've tried to make it as easy as possible for you to understand who we are, what we do and how we do it. After all, every individual, every household, every business, every organization and every institution in the United States–public or private–is a stakeholder, an owner, of the United States Postal Service. And this Annual Report is our accounting to you.

If you've only got four minutes, you might want to start with our financial highlights below. Then, review a summary of the year's business and operational highlights on page 3. Postmaster General and CEO Bill Henderson's letter on page 4 looks at the year's accomplishments and outlines our approach to the challenges of the future.

Of course, you'll find an in-depth discussion of our finances beginning on page 15, with a more thorough look at the year in review on page 6. A detailed discussion of the key challenges facing the organization, and how we propose to meet them, is on page 10.

Your Postal Service has been a key part of the nation's communications network for more than 200 years. And we're working to maintain its value and relevance for many years to come.

edding planner - Postal Inspector - Agricultural consultant - Chemical engineer - Knitting instruction - Antique refinishing - Catalog sales - Labor organization - Football coach - Gift



rtland, ME - Nanakuli, HI - Chicago, IL - Devils Lake, ND - Grand Rapids, MI - Hackensack, NJ - Silver Spring, MD - Woods Cross, UT - Pittsfield, MA - Elko, NV - Bridgeport, CT

FINANCIAL HIGHLIGHTS

	Years Ended September 30			Percentage Change from Preceding Year		
(dollars in millions)	2000	1999	1998	2000	1999	1998
Operating revenue	$ 64,540	$ 62,726	$ 60,072	2.9%	4.4%	3.2%
Operating expenses	62,992	60,642	57,786	3.9%	4.9%	4.9%
Operating income	1,548	2,084	2,286			
Operating margin	2.4%	3.3%	3.8%			
Net (loss) income	$ (199)	$ 363	$ 550			
Capital cash outlays(1)	$ 3,169	$ 3,624	$ 2,950	-12.6%	22.8%	-4.1%
Total debt	9,316	6,917	6,421	34.7%	7.7%	9.3%
Interest expense on borrowings	220	158	167	39.2%	-5.4%	-45.6%
Capital contributions of U.S. government	$ 3,034	$ 3,034	$ 3,034			
Accumulated losses at end of year(2)	(3,680)	(3,481)	(3,844)			
Total net capital deficiency(3)	(646)	(447)	(810)			
Number of career employees	787,538	797,795	792,041	-1.3%	0.7%	3.5%
Mail volume (millions of pieces)	207,882	201,576	196,905	3.1%	2.4%	3.2%

(1) Does not include capital leases and impact of reclassifications and adjustments included in audited financial statements.
(2) Losses Accumulated since Postal Service was created in 1971 with mandate to set rates such that revenue covers costs.
(3) Net Capital Deficiency equals Capital Contributions less Accumulated losses at beginning of year plus Net Income.

2000 Highlights

- Welcoming a new century—bug free. Years of painstaking preparation kept the mail moving and kept financial information and all other key systems intact.

- Watching our dollars. Despite huge and unanticipated rises in the cost of fuel and some employee benefits, we were able to trim spending by more than $1 billion, bringing us just about to the break-even mark for the year.

- Delivering record service. External First-Class Mail delivery scores, as recorded by Pricewaterhouse-Coopers, showed that 94 percent of First-Class Mail destined for next-day delivery received overnight service.

- Keeping customers satisfied. Customer satisfaction measurements showed that 92 percent of households surveyed had a positive perception of the Postal Service, with almost two out of three rating their satisfaction as "very good" or "excellent."

- Securing a safer workplace. The independent Commission on a Safe and Secure Workplace, led by Joseph Califano, found that Postal Service employees were far less likely than others to experience violence on the job. The Commission dismissed the phrase "going postal" as nothing but a "myth." Ongoing initiatives and implementation of recommendations in the Commission's report will benefit our employees with an even safer and more secure workplace.

- Celebrating diversity. Our successful and innovative diversity initiatives were recognized by the Vice President's Commission on Reinventing Government, which presented us with the prestigious Hammer Award. Echoing this finding, *Fortune* magazine found the Postal Service to be one of the 10 best workplaces for minority employees.

- Improving operations. We began deploying state-of-the-art flat-sorting equipment—the AFSM 100—which brings the efficiency, speed and accuracy of automation to the processing of catalogs, newspapers, magazines and larger envelopes. Innovative technology also has boosted the "read" rates of Optical Character Readers by 8 percent, further enhancing the automated processing of letter-size mail.

- Increasing productivity. Total factor productivity increased a remarkable 2.5 percent from last year's levels. Our Breakthrough Productivity Initiative, which focuses on operations, transportation, purchasing and administrative efficiencies, will help us to carry this progress into the future.

- Bringing you the world. We took the first steps in simplifying our international product offerings to make it easier for customers to select the level of service they need: fast, faster or fastest. Of course, there will be economy service, too. Global Express Guaranteed (formerly Priority Mail Global Guaranteed), our premier international expedited service, now offers delivery to 200 countries.

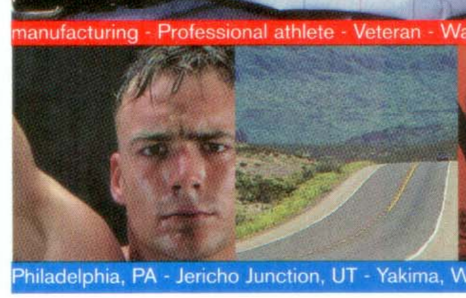
- Expanding a tradition of trust. Continuing to take advantage of new technology to offer solutions to customer needs, we've introduced a suite of electronic services that build on our long tradition of security and trust. USPS eBillPay is a quick, easy and inexpensive way to receive and pay bills—with the click of a mouse. Our Electronic Postmark provides a trusted time and date stamp for electronic communications. And PosteCS offers secure, global electronic courier service for individuals and businesses.

- Planning for a new tomorrow. Within the context of a radically altered competitive environment and an array of new communication technologies, we worked with Congress as it continued consideration of legislation that would provide a new regulatory model for the Postal Service.

- Keeping up with you. We've added the equivalent of a city the size of Chicago to our delivery network, expanding to accommodate an ever-growing nation.

- Winning the race. Lance Armstrong and the USPS Pro Cycling Team made the Tour de France their Tour de Force, chalking up their second consecutive win in the world's most challenging cycling event.

EXFC externally measures collection box to mailbox delivery performance. EXFC continuously tests a panel of 463 ZIP Code areas on the basis of geographic and volume density from which 90 percent of First-Class volume originates and 80 percent destinates. EXFC is not a system-wide measurement of all First-Class Mail performance.



Letter from the Postmaster General/CEO

ge designer - Flying instructor - Girlfriend - Vending machine repair - Watch repair service - Brick layer - Auditor

neapolis, MN - Steamboat Springs, CO - Errol, NH - Apple Valley, CA - Binghamton, NY - Fargo, ND - Pittston

While the obstacles to our success have never been greater, the results we achieved in 2000—through hard work, productivity and a commitment to innovation—are both noteworthy and admirable.

To the President, members of Congress, postal stakeholders and the American peo

The new millennium has brought both challenge and opportunity for the United States Postal Service and its employees. While the obstacles to our success have never been greater, the results we achieved in 2000—through hard work, productivity and a commitment to innovation—are both noteworthy and admirable.

Mail volume growth, network costs and revenue continue to be influenced by a broad range of external factors-many beyond our direct control. Technology is reshaping communication patterns and creating new ways for people to conduct business, interact with their government and become better informed. Competition confronts us in both traditional guises on traditional fronts and in the form of new challengers, such as foreign postal administrations, freed from stifling regulatory oversight, entering the U.S. marketplace. New competition has contributed to heightened customer expectations. Finally, our vast national postal network, unparalleled in both scope and capability, requires more and more resources, at a time when those resources grow scarcer.

Nevertheless, in the past year, the Postal Service and its people achieved record-setting performance in moving the mail from sender to recipient. We reached more delivery points than ever. We increased overall productivity to the highest level in almost a decade. And we designed, developed and introduced new products and services, eCommerce-focused and Web-enabled, to make our core business more efficient and to meet our customers' changing needs.

In this Annual Report, you will read about higher First-Class Mail delivery scores, new initiatives, and a path towards organizational change as embodied in our workplace safety and diversity initiatives. That we have accomplished so much in such an uncertain, challenging environment is testament to the skill, drive and loyalty of our employees. I salute them for their efforts.

g walker - Educational consulting - Limousine driver - Market research and analysis - Stationery printing service - Taxidermist - Interpreting service - Job placement - Ophthalmologi

iso, IN - Okonoko, WV - Paterson, NJ - Oklahoma City, OK - Paymaster

Looking forward, the Postal Service's journey gets no easier. Keeping our prices affordable, our costs down and our revenue growing through valued products and services is a mandate we all have to embrace.

One of our greatest challenges is addressing a competitive environment that is changing at an ever-increasing speed while constrained by a regulatory charter that is nearly three decades old. We will continue to press for regulatory reform, seeking a new charter that includes pricing flexibility, the ability to introduce the new products defined by our customer's needs, and investment versatility.

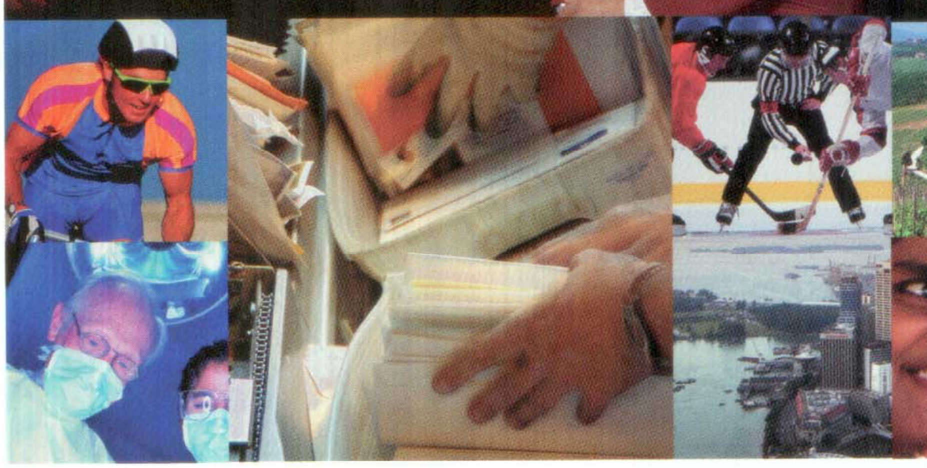
We must stay this course to remain the great American institution that we are, binding the Nation together, reaching all of its citizens through universal access and service, and delivering our promise.

Sincerely,

William J. Henderson

Postmaster General and Chief Executive Officer

United States Postal Service



Automation
Fast, Accurate, Efficient

When you have to move a mountain of mail every day, you need all the help you can get. That's why the Postal Service continues to expand and improve automation in processing and delivery operations.

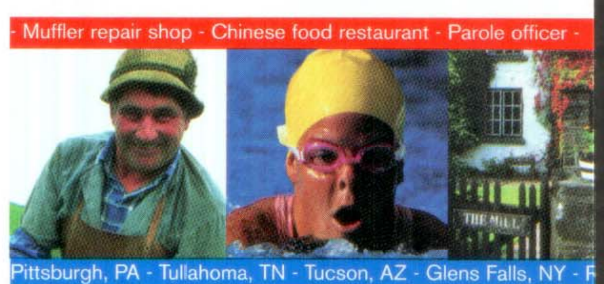
It makes a difference. Every day, we handle 668 million pieces of mail. That's more than double the mail volume we handled when the Postal Service opened for business almost 30 years ago. And here's the interesting part—during the same period, our workforce has grown only 25 percent! How did we do it? Automation. It's the fastest, most accurate and most cost-effective way to keep your mail moving.

Building on this record, we expanded our focus on automation in 2000 with the initial deployment of new state-of-the-art flat-sorting equipment, the AFSM 100. It brings the processing advantages long enjoyed by letter-size mail to magazines, catalogs, newspapers, advertising circulars and other items of similar size and shape. How good is the AFSM 100? Only about three times more productive than the equipment it replaces. When fully operational and integrated into the mail processing system, each AFSM 100 will process 300,000 flats a day—improving speed and accuracy of flats processing and helping us to contain costs. Better service and affordability. Not bad!

At the same time, we continued our efforts to improve automated processes for other types of mail. Funding was authorized to expand the ability of Multi-line Optical Character Readers to sort a wider range of letter sizes. This is significant—while only about 8 percent of the letter mail we receive each day is processed manually, it accounts for one-half of letter mail processing labor costs. Manual sorting, at about $55 per thousand letters, costs about 10 times more than automated processing. This change will help us move an additional half-billion pieces of letter mail to automated operations.

In the package area, we have purchased smart technology that will align, measure and sort bar coded parcels—without the need for labor-intensive manual sorting. The technology also streamlines the purchase and return of goods purchased over the Internet. Prototype units have been deployed and tested at our Dallas and Pittsburgh Bulk Mail Centers. When fully implemented, the new technology is expected to result in annual labor savings of more than $24 million.

We'll continue using the best in technology to keep our products affordable and, by enhancing the service we provide, contribute to the growth of the mailing industry.



Expanding Our Information Platform
We're on the cutting edge of technology.

Our growing Information Platform is linking the systems we use to process and deliver the mail, spurring on the electronic exchange of information with our customers, among postal facilities and within postal operations.

State-of-the-art automation is allowing us to sort large envelopes, catalogs, newspapers and magazines with breakthrough efficiency. The results are increased productivity and reduced labor costs that are helping keep the mail affordable by lowering the cost of doing business. In July 2001, we'll deploy new speed-reading flat sorters that are expected to increase productivity by at least 12 percent and throughput by at least 20 percent and reduce staff needed to support the equipment by about 22 percent.

A cornerstone initiative currently underway will extend the Information Platform to local post offices, too. Already our delivery unit computers are being upgraded with new Delivery Operations Information System (DOIS) software that will enable us to improve delivery performance (specifically time-of-day delivery). In the end, we'll do an even better job of meeting our customers' needs and expectations with improved consistency and timeliness of delivery, increased productivity and decreased costs that help keep the mail affordable. It's happening now.

Doing the Right Thing
Making our environment a safer, cleaner place

We're leaders in environmental issues. We didn't plan on becoming a role model. We were simply doing the right thing. From electric vehicles to windmills, from straw buildings to environmentally benign adhesives, we're serious about protecting the environment — making it a cleaner and safer place to live. Our innovative approaches to delivering on that commitment just came naturally.

We've partnered with Per Scholas, a non-profit organization dedicated to bridging the digital divide by bringing 21st century technology to schoolchildren and low-income families, in dedicating its new Access Computer Recycling Center. We donated 15,350 units of surplus electronic equipment for recycling. Postal Service vehicles transported the computers for reconditioning to the Center and distributed refurbished units to families without computers.

We're proud to be one of our nation's largest recyclers. We operate more than 20,000 recycling centers, and we're the nation's largest user of recycled motor oil and retreaded tires. Our stringent purchasing requirements resulted in the purchase of more than $200 million worth of products with recycled content — items we use every day in processing the mail, like pallets and trays, and things our customers use every day, like stamp products and mailing envelopes. By recycling undeliverable mail and other materials, we've turned a former waste disposal expense into a revenue-generating business, increasing revenue from recycling by 60 percent last year.

We're also proud to drive the nation's largest fleet of alternative-fuel vehicles (AFVs) that operate on clean-burning compressed natural gas or electricity. More than 7,500 Postal Service vehicles have been converted to compressed natural gas, and we've purchased 21,275 flexible fuel vehicles that can run on ethanol or gasoline. By 2002, the Postal Service's AFV fleet will grow to nearly 30,000 vehicles.

And finally, we work hard to ensure that even the tiniest elements of our business are good for the environment. We print nearly 45 billion stamps a year. That's a lot of stamps! When recycling units told us the adhesive we used on the backs of postage stamps left tiny particles of sticky residue that gummed up the works at recycling mills, our engineers, along with industry professionals, went to work to find a "cure." Together, we developed environmentally benign pressure-sensitive adhesives — postage stamps that don't gum up the works, allowing the flow of recycling to continue uninterrupted and saving valuable time and money, too. That's proof-positive that, when it comes to the environment, little things can make a big difference.

Raising Awareness
Funds raised, causes supported

Each day, we are touched in some way by the content of our mail. Letters from home, sale flyers from our favorite department stores—the mail binds our nation together with each message that it brings. With it also come the hopes of millions of people carried upon a single thumb-sized symbol that clings to the outside of most envelopes. It's a U.S. postage stamp.

World peace, adoption, energy conservation, hunger, AIDS awareness—postage stamps have helped raise awareness of health and social issues for more than 60 years. Organ and tissue donation, hospice care, the loving act of adoption—it's a proud tradition, one that you've been a part of every time you purchased one of these postage stamps.

In 1998, the Postal Service issued our nation's first ever semi-postal stamp, created to call attention to a disease that threatens the lives of hundreds of thousands of women each year—breast cancer. The Breast Cancer Research (BCR) semi-postal stamp was the first in our history to have its net proceeds above the cost of postage earmarked for research.

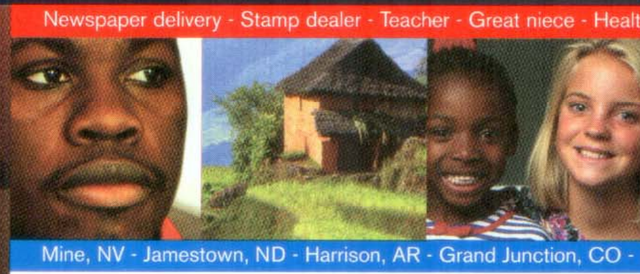
It's a worthy cause. And we're serious about funding the fight to find a cure. Our partners, American Express, Kaiser Permanente, Lifetime Television, Revlon, the Women's Information Network Against Breast Cancer, and the Women's National Basketball Association are all equally dedicated, giving time and resources to promote the stamp and build awareness.

The BCR semi-postal stamp is valid as postage at the current First-Class rate. It sells for 40 cents with up to seven cents per stamp going to research organizations—the National Institutes of Health and the Medical Program of the Department of Defense.

Two years of sales raised $16.8 million in voluntary contributions with $8.2 million raised in fiscal year 2000. The Postal Service has recovered approximately $500,000 in costs related to the first two years of the program.

In promoting the BCR semi-postal stamp we've learned a few lessons—the relevance of preventative health care, the value of early detection and the wisdom of getting a mammogram. We're working to share these lessons with the American public. Put into action, they may save more lives than any amount of money ever could. Already, 2.6 million women live with breast cancer. They are depending on us to help fund the fight to find a cure. We'll keep trying.

2000 in Review



Multicultural Initiatives

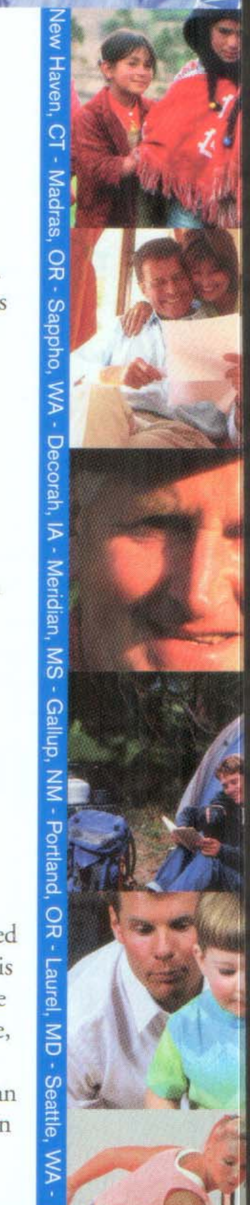
Enriching our culture

First, we won a prestigious Hammer Award for Diversity. The award highlighted our success in integrating diversity into strategic planning, closing the gap between initial-level supervisor programs and advanced leadership programs, and reaching out to customers through supplier diversity and recruitment. Of course, we were proud.

Then, *Fortune* magazine ranked us among the top 10 best companies for minorities. That, too, was quite a compliment, and an affirmation that we were on the right track. So we've made it our business to continue living up to the standards we've set for ourselves with new multicultural initiatives that further address the needs of our diverse customer base.

Those initiatives began taking shape with the launch of our newest website, www.USPS.com/correo, designed specifically with our Spanish-speaking customers in mind. Written entirely in Spanish, www.USPS.com/correo is a valuable key to understanding the range of services and employment opportunities offered by the Postal Service.

We've established performance-based contracts with three top advertising agencies, each selected for its expertise in addressing specialty markets. We had a goal in mind: Reach the growing African-American, Asian-American and Hispanic-American markets in the United States, because each represents a groundswell of purchasing power and a market too big to be ignored. So we've given the agencies incentives to reach results-based goals; to work together on ad campaigns that channel information, advertising and publicity toward these communities; and to help make our services more accessible and relevant to minority-owned businesses. Ultimately, we'll enrich our own business and bring to even more Americans the quality service expected from the United States Postal Service. It really is universal.



Tour de France

A tour de force

Speed. Focus. Reliability. And, of course, teamwork. That was the winning formula for Lance Armstrong and the entire USPS Pro Cycling Team as they rode to their second consecutive victory in the world's most challenging cycling event, the legendary Tour de France.

That formula is the same one that drives performance for the Postal Service, one of the nation's most respected brands.

When they made their victory lap, amid the cheers of thousands along Paris' Champs Elysées, Lance and his eight teammates—members of the only American-sponsored team—were all still rolling. They were the only one of 20 teams, totaling 180 riders, that started the race and finished intact.

Armstrong took the yellow jersey—the "maillot jaune," signifying the race leader—less than halfway through the race after a magnificent ride in the Pyrenees mountains that left his closest competitors trailing far behind. It never left his shoulders again. The team was flawless in its protection of Armstrong for the rest of the grueling, 2,276-mile, three-week race.

With the team's victory clinched, the Postal Service brought the excitement to the streets, post offices and mailboxes of America, with millions of specially designed Priority Mail envelopes. They featured a photo of a beaming Armstrong, his arms raised in triumph, sporting the winner's yellow jersey and, of course, the proud eagle logo of the Postal Service. The same image—larger than life—rolled through major American cities on the sides of 10,000 Postal Service delivery vehicles.

e-Business Initiatives

We're wired for e-communications, too.

Since the earliest days of this country, the Postal Service has connected Americans in every neighborhood and city. It just seemed right that we'd reach out to make sure that universal service is also available in our newest community, the online community.

Through agreements with CheckFree Corporation and YourAccounts.Com, a division of Output Technology Solutions, we're offering customers a secure electronic billing and payment service. We call it *USPS eBillPay.*

Why did we go there? Simple. Generations growing up with PCs will undoubtedly move to conducting business on the Internet. We plan to be there, ensuring secure, reliable service via the Internet with the same level of commitment we've delivered on paper for more than 200 years.

With *USPS eBillPay,* we're offering billers and payers what they've been asking for—a central site for bill-paying transactions, without having to deal with separate passwords and navigation systems for each biller.

Our customers just click on the *USPS eBillPay* button on our home page at www.usps.com to enroll in the service and select the billers they want to receive electronic bills from through the secure Postal Service website. Billers send their bills electronically through our system for distribution to customers. Then, customers can conveniently and securely view and pay their bills online.

What's more, we ensure that any bills delivered through *USPS eBillPay* are secure. This new service can verify that senders are who they claim to be, giving consumers an added layer of security.

Another great enabler of electronic communications is *NetPost Mailing Online.* It offers our customers the best in electronic service convenience and reaffirms the relevancy of hardcopy mail at the same time. How's that possible? It's all in the doing.

NetPost Mailing Online lets mailers electronically (and cost-effectively, too) transmit their documents, correspondence, newsletters and other First-Class Mail and Standard Mail (A), along with their mailing lists, to the Postal Service via www.usps.com. The electronic files are securely distributed to printers who print, insert, address, apply postage, sort and transport the mailing to the nearest post office for processing and delivery. See the connection?

It's an electronic to hardcopy triumph. But we're most proud of the fact that it's affordable. We can offer *NetPost Mailing Online* to our customers for about 40 cents an item—just pennies over the cost of mailing a letter.

And we're open for e-business at www.usps.com. When our *Postal Store* opened its e-doors to the public, it brought the speed and convenience of secure online shopping to customers looking to buy postage and other postal products.

Visitors to the site can use their credit cards to purchase stamps and philatelic items 24 hours a day. They simply browse the store aisles for special stamp releases, commemoratives and new stamp issues, books and panes. First-Class Phonecards, stamp-themed stationery and USPS Pro Cycling Team gear are also among the many treasures e-shoppers find inside the *Postal Store.*

Our high service-performance standards have led our web designers to install user-friendly navigation tools that make it easier for e-shoppers to find the items they want.

And we added a postal-secure shopping cart that conveniently calculates shipping and handling charges. The *Postal Store* processes credit card payments, too. Customer orders are processed within 24 hours, and our letter carriers deliver them within three to five days. It's an e-solution that supports growth. We think it's a good idea.

spaper delivery - Paramedic - Stamp collector - Telecommunications - Butcher -

h, AR - Chama, NM - Gainesville, FL - Monroe, LA - Thief River Falls, MN - Wilmington, NC - Running Water, SD - Las Vegas, NV - Centralia, IL - Bowling Green, KY - Jefferson Ci

Delivering the Future

The Postal Service remains a key element of the nation's complex communications network. In many ways, the Postal Service and its customers are experiencing the best of times. Service remains at an all-time high. Postage rates are among the lowest in the world. The Postal Service brand offers unparalleled reach and value, providing mailers with a unique gateway to the household.

But the Postal Service is no different from any other business in America. Technology is changing everything—and faster than anyone expected. And we must change along with it to protect the values that support our brand—tradition, trust, reliability, scope and affordability.

The simple fact is that we are at a crossroads. Keeping the mail relevant in the future will require new ideas and new business models. Without them, the best of times can easily become the worst of times—both for the Postal Service and for the mailing community, whose success is so closely tied to our own. Our approach to future success is based on meeting three critical challenges: affordability, mail industry growth, and reform in our regulatory environment.

Affordability

We have to continue to transform the Postal Service into the supplier of choice for high-quality, low-cost products and services. We have to be affordable. We have to bring our internal cost structure down and restrain prices. That is the only way we will survive if, as projections suggest, key segments of our letter mail volume migrate to electronic messaging.

This is not just a Postal Service issue. It is not just about the price of postage. It is about the combined cost of conceiving, producing, preparing, collecting and delivering a single piece of mail. When the total investment in that moment can cost more than $1 for each piece of mail, we have to be concerned about helping our customers limit their transaction costs.

Breakthrough Productivity: The Key to Cost Control

Our breakthrough has begun. The year 2000 was marked by sustained and significant increases in total factor productivity. Overall, productivity grew by 2.5 percent over 1999, the best results since 1993. Our success in building a culture of operational excellence has been the primary contributor to this success, helping us to drive billions of dollars of costs out of our system over the past two years to compensate for revenue that, while growing, has not matched expectations.

We are formalizing this approach through our Breakthrough Productivity Initiative. We have completed a comprehensive review of activities and transactions, and we are moving to centralize support functions, eliminate duplication and reduce administrative staffing.

Significant savings will come from more efficient paperwork and purchasing practices. We are already seeing results through centralized telecommunications and supply contracts. We will also reduce transportation costs by using more ground transportation and better deploying the contract capacity we have—while still maintaining service standards. We are reducing steps in the distribution and handling of mail, too.

The lion's share of these reductions will come from dramatic, breakthrough productivity in our processing system. We will reduce costs through everything from machine utilization to standardization of processes, to staffing and scheduling, to resource management. It means tracking mail throughout the system, benchmarking, measuring performance and understanding the costs of every activity.

Breakthrough productivity is a multi-year approach to remaining successful through the immediate challenges of a rapidly changing communications marketplace.

Adding Value to What We Do

The Postal Service does not thrive by cost cutting alone. We have to nurture the business, too. We know today's consumers are more savvy than ever. They appreciate tradition – and thrive on innovation. They spend their evenings reading novels by literary giants and popular authors. But instead of making a trip to the bookstore, they order best sellers online, then have them delivered by mail. They like the speed, flexibility and convenience of electronic communication. Why shouldn't they? We live in a fast-paced world.

The Postal Service has a firm understanding of the changes that are occurring in the way we communicate. With that understanding, our commitment to providing universal service—to everyone, everywhere, every day—is expanding to include the Internet.

It's where a lot of our customers are headed. Our efforts to reach them where they live and work these days have given rise to a host of hybrid postal products that combine the trust of traditional mail, with the potential of the Internet. We think these products and services are just what

ddy - Engraver - Fashion consulting - Trucking - University - Museum curator - Newsletter production - Credit bureau - Dancer - Museum - Park ranger - Sporting goods - Telemark

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Nearly five years of debate about postal reform–in the Congress, in the Postal Service and in the mailing community–has generated a number of thoughtful but, ultimately, unsuccessful reform bills.

America's Internet-savvy consumers are looking for.

We've introduced web-based services that build on our tradition of trust and security. USPS eBillPay is a quick, easy and inexpensive way to receive and pay bills – with the click of a mouse. Our Electronic Postmark provides a trusted date and time stamp for electronic communications. And, with the introduction of PosteCS, we bring secure, global electronic document delivery to individuals and businesses. And we're not done yet.

You see, we've begun creating new products and new revenue streams to ensure that the nation's Postal Service remains a viable player in the communications industry of today, and tomorrow.

We are continuing to strengthen our core products. First-Class Mail continues to offer tremendous value and visibility. People still want to touch and read their publications. Advertising mail is seen by many to be the best medium for developing long-term customer relationships, for both traditional and e-businesses. Beyond that, the e-business boom presents phenomenal growth opportunities for Express Mail, Priority Mail and package delivery. Today's global economy is an invitation to greater use of international mail products. And, all day, every day, our online services let customers buy stamps and postage, confirm delivery, arrange for package returns, get ZIP Code information, locate post offices and order Priority Mail and Express Mail supplies.

We're continuing to add value to our products and services. Just watch. You'll be seeing some exciting innovations in the months to come.

Regulatory Reform: An Absolute Requirement

The ability of the Postal Service to change and continue to meet customer needs is not a question of will. We are controlling costs, improving existing products and services and developing new ones. What we cannot control is a regulatory model that was created in a far different competitive environment.

Regulation constrains us from fully realizing our potential to operate in a businesslike manner. Our rate-making process supports a rigid pricing system that, while cost based, does not allow us to fully leverage our assets by adjusting pricing to meet market conditions.

Nearly five years of debate about postal reform—in the Congress, in the Postal Service and in the mailing community—has generated a number of thoughtful but, ultimately, unsuccessful reform bills. Unfortunately, we still lack the flexibility we need for long-term success in today's competitive environment.

We continue to seek commercial freedoms, including market-based pricing, flexibility in introducing new products, the ability to generate income for investment and a labor-management model that brings the voice of our customers to wage decisions that, in affecting hundreds of millions of dollars in labor costs, directly affect the prices they pay.

The lines between public and private providers of postal products and services are blurring. We must be able to compete fairly and to act in concert with the needs of our customers.

Other posts are already realizing the potential of commercial freedoms, with their governments allowing them to aggressively come to terms with the new business environment. They are free to invest, able to enter into forward-looking pacts with labor, and encouraged to seek partnerships, alliances, and new markets, including expansion into the United States.

The need for regulatory reform grows stronger with each passing day. We will continue our efforts to achieve a new regulatory model that, in helping the Postal Service to succeed, helps our customers as well.

turing - Aerospace industry - Chemist - Marketing consulting - Speech therapy - Tenant - Dog grooming - Electrician - Printer - Rental management - Tour guide - Tree cutting -

- Brockton, MA - Worland, WY - Milwaukee, WI - Hutchinson, KS - Durango, CO - Alamogordo, NM - Panama City, FL - Woonsocket, RI - Norfolk, NE - Eek, AK - Muncie, IN -

The Governors of the Postal Service

The governors (left to right): Alan C. Kessler, Tirso del Junco, John F. Walsh, LeGree S. Daniels, Robert F. Rider, Ernesta Ballard, Einar V. Dyhrkopp, Ned R. McWherter and S. David Fineman.

The Postal Service Board of Governors is comparable to the board of directors of a publicly owned corporation. The Board meets monthly in Washington, DC, or other cities across the United States.

Nine governors are appointed by the President with the advice and consent of the Senate. They, in turn, select the Postmaster General, and along with the Postmaster General, select the Deputy Postmaster General, both of whom also serve on the Board.

The Board directs and controls expenditures of the Postal Service, reviews its practices, joins in long-range planning and sets policies on all Postal Service matters. Many of these activities are coordinated through the various committees of the Board.

Einar V. Dyhrkopp, Chairman

Appointed November 1993, term expires December 2001. President of Tecumseh International Corp.; Regional Advisory Board member of the Southern Illinois University Public Policy Institute.

Robert F. Rider, Vice Chairman

Appointed May 1995, term expires December 2004. Capital Projects and Strategic Planning Committee, and Postal Museum Advisory Commission. Chairman and CEO of O.A. Newton & Son Co.; Trustee of the University of Delaware and Director of several companies and institutions.

Ernesta Ballard

Appointed November 1997, term expires December 2005. Audit and Strategic Planning Committees. President and founder of Ballard & Associates, which advises clients on complex management problems that require long-range planning. Board member of Ketchikan General Hospital, LifeCenter Northwest and Alaska Forest Association.

LeGree S. Daniels

Appointed August 1990, reappointed November 1999, term expires December 2007. Capital Projects and Compensation Committees. Former U.S. Department of Education Assistant Secretary for Civil Rights; Member of Pennsylvania State University Board of Advisors, Harrisburg Campus.

Tirso del Junco, M.D.

Appointed July 1988 reappointed December 1991, term expires December 2000. Compensation and Strategic Planning Committees. Surgeon and entrepreneur; Past Chairman of Board of Regents, University of California.

S. David Fineman

Appointed May 1995, term expires December 2003. Capital Projects and Compensation Committees. President, Fineman & Bach, P.C.; Member of the Industry Policy Advisory Committee, advising the U.S. Secretary of Commerce and U.S. Trade Representative on international trade policy issues.

Alan C. Kessler

Appointed November 2000, term expires December 2008. Audit Committee. Partner in Wolf, Block, Schorr and Solis-Cohen, LLP. Member, Board of Directors of Philadelphia Industrial Development Corporation; Chair, Pennsylvania Supreme Court's Continuing Legal Education Board.

Ned R. McWherter

Appointed October 1995, term expires December 2002. Audit and Capital Projects Committees. Former Governor of the State of Tennessee (1987-1995); Officer and/or Director of several companies and institutions.

John F. Walsh

Appointed November 1999, term expires December 2006. Audit and Compensation Committees. Former Deputy Controller of the City of New Haven, Connecticut. Officer and/or Director of several companies and institutions.

Sam Winters

Term as Governor expired in December 1999, continued to serve on the Board beyond the expiration of his term, until November 8, 2000, as prescribed by law.

Also members of the Board of Governors:

William J. Henderson

Appointed 71st Postmaster General of the United States in May 1998. Career Postal Service employee who has served in senior management positions including Chief Operating Officer, Chief Marketing Officer and Vice President of Employee Relations.

John Nolan

Appointed Deputy Postmaster General in February 2000. Career Postal Service employee who served as General Manager & Postmaster of New York. Served as Director of Operations at Merrill Lynch Production Technologies from 1989-2000.

Audit Committee

Chairman's Letter

The Audit Committee assists the full Board of Governors in fulfilling their fiduciary requirements. The Chairman of the Board of Governors selects the members of the Audit Committee for each calendar year. This year, the Committee, whose members are Governors Walsh, McWherter, former Governor Winters and I, met six times in conjunction with the regularly scheduled monthly Board meetings.

The Audit Committee is responsible, on behalf of the Board of Governors, for reviewing the financial reporting process, ensuring the soundness of the internal accounting and control practices and the integrity of the financial statements of the Postal Service. The Committee also recommends to the Board of Governors, the selection of the independent certified public accounting firm responsible for the external audit work and oversees compliance with the terms of the contract.

During Calendar Year 2000, we recommended that, based on our review of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees, the Board approve a number of changes to the Charter of the Audit Committee. The Blue Ribbon Committee also recommended that companies publish their Audit Committee Charter every three years, so we include below the full text of our revised Charter, as approved by the Board. In addition, we recommended, and the Board approved, a timely and efficient audit resolution process between Postal management and the Office of Inspector General. We also recommended the Board approve that, starting in 2001, responsibility for the internal financial installation audit be transferred from the Inspection Service to the Office of Inspector General, and this transition began in 2000. Finally, we recommended and the Board approved Ernst & Young LLP for the 2001 audit.

At the start of the audit of the 2000 financial statements, we discussed the overall scope of work and the audit plans with Ernst & Young LLP, the Office of the Inspector General and the Postal Inspection Service. We also met jointly and independently with them as well as with management and the General Counsel to discuss the progress of the audit and their evaluation of the organization's internal controls and the quality of the financial reporting process. We assessed the coordination of the audit and ensured independence and objectivity in the internal and external audit programs.

Accordingly, the Committee recommended and the Board approved the financial statements for 2000.

Ernesta Ballard
Chairman, Audit Committee
December 5, 2000

Charter of the Audit Committee

In response to the general concerns of the Securities and Exchange Commission about the functions of audit committees, the New York Stock Exchange and the National Association of Securities Dealers sponsored the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees. This committee made excellent recommendations. Although we are not required to adopt these recommendations, we have voluntarily amended our Audit Committee Charter to help ensure that all stakeholders understand the Audit Committee's composition, duties and responsibilities, and that effective communication exists between the Board of Governors, management, the Office of Inspector General and our external auditors.

The Postal Reorganization Act provides that the Board of Governors (the Board) "shall direct and control the expenditures and review the practices and policies of the Postal Service." The Board "may establish such committees of the Board, and delegate such powers to such committees, as the Board determines appropriate to carry out its functions and duties." Pursuant to this authority and to Sections 4.1 and 5.1 of the Bylaws, and to assist it in the execution of its statutory responsibility, the Board has established the following charter for its Standing Audit Committee.

IT IS, THEREFORE, HEREBY RESOLVED:

Organization

This charter governs the operations of the audit committee. The audit committee is a committee of the Board of Governors. The duties and responsibilities of a member of the audit committee are in addition to those duties set out for a member of the Board of Governors. The charter will be reviewed and reassessed by the committee and will be approved by the Board of Governors, at least annually. The committee shall be appointed by the Chairman of the Board in accordance with Section 4.1(a)(2) of the Bylaws and shall comprise at least three Governors of the Postal Service, each of whom are independent of management and the Postal Service. Members of the committee will be considered independent if they have no relationship that may interfere with the exercise

continued

Audit Committee

Charter of the Audit Committee continued

of their independence from management and the Postal Service. All committee members will be financially literate, or will become financially literate within a reasonable period of time after appointment to the committee, and at least one member will have accounting or related financial management expertise.

Statement of Policy

The audit committee will provide assistance to the Board of Governors in fulfilling its oversight responsibility relating to the Postal Service's financial statements and the financial reporting process, the systems of internal accounting and financial controls, the Inspection Service function, the Inspector General's function and the annual independent audit of the Postal Service's financial statements. In so doing, it is the responsibility of the committee to maintain free and open communication between the committee, independent certified public accountants, the Inspection Service, the Inspector General and management of the Postal Service. In discharging its oversight role, the committee is empowered to investigate any matter brought to its attention with full access to all books, records, facilities and personnel of the Postal Service and the power to retain outside counsel or other experts for this purpose.

Responsibilities and Processes

A significant responsibility of the audit committee is to oversee the Postal Service's financial reporting process on behalf of the Board and report the results of their activities to the Board. Management is responsible for preparing the Postal Service's financial statements, and the independent certified public accountants are responsible for auditing those financial statements. The committee, in carrying out its responsibilities, believes its policies and procedures should remain flexible, in order to best react to changing conditions and circumstances. The committee should take the appropriate actions to set the overall "tone" for quality financial reporting, sound business risk practices and ethical behavior.

The following shall be the principal recurring processes of the audit committee in carrying out its oversight responsibilities. The processes are set forth as a guide with the understanding that the committee may supplement them as appropriate.

The committee shall have a clear understanding with management and the independent certified public accountants that the independent certified public accountants are ultimately accountable to the Board and the audit committee. The committee shall have the ultimate authority and responsibility to evaluate and, where appropriate, replace the independent certified public accountants. The committee shall discuss the independent certified public accountants' independence from management and the Postal Service and the matters included in the annual written disclosures required by the Independence Standards Board. Annually, the committee will review and recommend to the Board the selection of the Postal Service's independent certified public accountants.

The committee shall discuss with the Inspection Service and the Inspector General's office the overall scope and plans for their respective audits including the adequacy of staffing and the compensation. Also, the committee will discuss with management, the Inspection Service, the Inspector General's office and the independent certified public accountants the adequacy and effectiveness of the accounting and financial controls, including the Postal Service's system to monitor and manage business risk, and legal and ethical compliance programs. Further, the committee will meet separately with the Inspection Service, the Inspector General's office and the independent certified public accountants, with and without management present, to discuss the results of their examinations.

The committee shall invite the independent certified public accountants to attend the full Board of Governors meeting to assist in reporting the results of the annual audit or to answer other Governors' questions.

The committee shall periodically review the interim financial statements with management. Also, the committee will discuss the results of the interim financial statement review and any other matters required to be communicated to the committee by the independent certified public accountants under generally accepted auditing standards. The chair of the committee may represent the entire committee for the purposes of this review.

The committee shall review with management and the independent certified public accountants the financial statements to be included in the Postal Service's Annual Report, including their judgment about the quality, not just acceptability, of accounting principles, the reasonableness of significant judgments and the clarity of the disclosures in the financial statements. Also, the committee will discuss the results of the annual audit and any other matters required to be communicated to the committee by the independent certified public accountants under generally accepted auditing standards.

Authority and Execution

Nothing in this charter shall be construed as inconsistent with the Postal Reorganization Act, or as circumscribing the Inspector General's authority under the Inspector General Act, 5 U.S.C- app., or is intended to restrict the Inspector General's authority to conduct, supervise and coordinate audits and investigations relating to programs and operations of the Postal Service.

This Resolution supersedes Resolution 82-1, adopted February 9, 1982; Resolution 85-2, adopted February 5, 1985; Resolution 95-11, dated August 1, 1995; and Resolution 98-7, adopted June 30, 1998.

The foregoing Resolution was adopted by the Board of Governors on June 6, 2000.

Financial Section

Overview

In this section we discuss our finances, including the successes we had, the challenges we face, our plans for the future and the risks that lie ahead. If we were a private company as opposed to a government agency, your financial analysis of our results would focus primarily on our bottom line, which this year is a loss of $199 million. However, if you focus on this loss you will not get an accurate picture of our results. When you examine our total picture, you will see that this was our most productive year in the past seven years. This achievement was no accident. Management responded to significant financial challenges, lower than expected revenue and soaring fuel costs by setting in motion a plan that took the hard work of hundreds of thousands of our employees. The result was record levels of productivity that averted what could have been a much greater loss.

To understand just how difficult this achievement was, you should remember that we did it in the context of our universal service mandate, which means we deliver to everyone, everywhere and we do not charge whenever we add a new delivery address. Every day we deliver to over 5,000 new addresses in the delivery network, which is the equivalent of adding a city the size of Chicago each year to our delivery system. And we provide universal service without the flexibility to change our rates quickly whenever our costs go up. For example, in 2000, our transportation costs increased $275 million when the price of fuel went up. While our competitors and other companies, such as airlines, can quickly add a fuel surcharge to their prices to cover their increased costs, we must wait until our next rate case, which can take over a year, to recover our increased costs.

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Financial Q&A with the CFO

Some frequently asked financial questions about the Postal Service answered by Richard J. Strasser, Jr., Chief Financial Officer & Executive Vice President.

The Postal Service has described its 2000 performance as successful, despite a reported net loss of $199 million. What criteria do you use to measure your success?

We did have a tremendously successful year, challenging, but successful. Our levels of customer satisfaction and service remained extremely high, while we generated record productivity increases. Thus, our financial result for the year is but one of the indicators we use in evaluating the organization's performance. We are, however, not a for-profit operation, rather our financial mandate is to "break even over time."

This year fuel prices accelerated, also driving up the Consumer Price Index (CPI). This directly increased our transportation costs and, through cost of living adjustments contained in our labor contracts, increased our labor costs. Our comprehensive measure of productivity, Total Factor Productivity (TFP), is tracked by an economic consultant. For 2000, we increased our productivity by 2.5%, thereby saving $1.6 billion in expenses. This was not enough to offset the significant inflation in costs; thus we experienced a $199 million loss compared to a net income plan of $100 million.

In specific terms, however, we delivered more mail to more businesses and households than the previous year, and we used 6,200 fewer work years.

That sheds light on your governmental mandate of efficiency, but what about operating in a "businesslike" manner?

This second mandate is best understood in the guidance given by law. We are to set our rates so that, over time, revenue covers expenses. This was our plan for 2000. To put that into perspective our actual bottom line loss of $199 million is less than half of one day's cash receipts for us. Compared to our revenue of over $64 billion, many would consider this to be virtually break even.

But we recognize that just like a for-profit company, we must carefully watch our bottom line. To do this we use a measure that is more comprehensive than net income. This measure, used by many successful companies, is called Economic Value Added (EVA). Put simply, EVA measures the change in financial worth of the Postal Service from one year to the next. It is more comprehensive than net income (revenue minus expenses) alone, because it includes the cost of the capital used to generate that income and the economic impact of inflation. It is focused on producing long-term value. Our indexed EVA was $1.8 billion in 2000. So you can see, 2000 was a very successful year for increasing the long-term value of the Postal Service.

You mentioned that the Postal Service faced challenges during the year. Can you elaborate?

Every year we have one challenge that never varies. When a customer requests service to a new address, we must add it to our delivery network. And, we do it for free. No for-profit organization would do that. Last year, customers requested over 1.7 million new addresses. That is equal to over 5,000 new addresses per day and is roughly equal to a city the size of Chicago every year. Historically, we have been able to recover the cost of this free service because volume and thus revenue has grown at approximately the same rate as the economy. This historic trend did not hold true this year. Our forecast was off by over $800 million. This revenue shortfall presented a tremendous challenge, because we had committed to breaking even.

Other forces in the economy, notably dramatic increases in oil prices, added to our challenge. All told, the increase in oil prices raised our transportation costs an additional $275 million in 2000. We use approximately 300 million gallons of diesel fuel, 160 million gallons of aviation fuel and 90 million gallons of gasoline. In addition to the fuel we use directly, our airline and trucking contractors are able to quickly pass on their fuel increases to us, something we can not do to our customers. Our labor costs are directly influenced by growth in inflation. This year wages increased almost $1.3 billion. Medical expense inflation heated up again in 2000, increasing health benefits expenses by 9.4%, or $265 million. Remember that all of these unplanned cost increases are happening while our postal prices remain constant.

In view of the experience of 2000, how does this impact your request for a general rate increase?

Our experience in 2000 is why in each rate case we request a certain amount for contingencies. Our rate case contingencies are the unforeseeable events that we cannot estimate. There are many uncertainties in the New Economy as well as risks within our business. Our forecasting models do not have experience yet with the New Economy. Examples of this change that were evident in 2000 are revenue growth below historic trends, the increase in fuel prices, medical inflation and workers' compensation claims.

What are your plans to ensure Postal Service liquidity?

For years we have been developing strong relationships with commercial banks. And we have worked in tandem with the U.S. Treasury to have available the credit lines we need. This has come about through adoption of state of the art cash management practices. So liquidity is not usually a problem. While the Postal Service did lose money this year and at the present time we do foresee a loss occurring in 2001, they are not material to our liquidity. For now, our borrowing is still below the peak level reached in 1992.

Will this be enough in the challenging years ahead? Not entirely. Net cash flow from operations is the true measure of liquidity in the future. If we continue to face revenue shortfalls, we must increase our efforts at managing our costs, improving our productivity, and prioritizing our capital projects to achieve the best possible returns.

What financial challenges do you foresee in the immediate future?

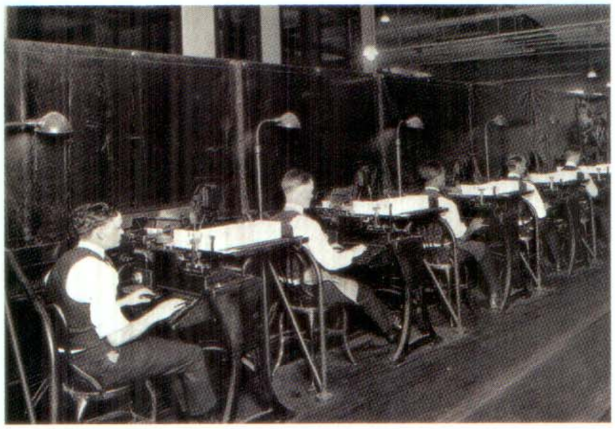
It is clear that the Postal Service was not a beneficiary of the roaring communication market of the 90's. Research shows that there are now far more emails sent than hardcopy mail. We must adjust to a forecast of lower growth in our volume of mail. Lower growth in volume equates to less revenue. Even within our volume growth there are significant changes taking place. Mailers are moving to the more cost advantageous categories of mail to maximize their discounts.

In addition, our workers' compensation costs are increasing at an alarming rate. The Department of Labor administers this program, and we have begun discussions with them to identify the root causes of the cost increases. While we will continue our efforts to improve our safety record, we will also review why non-accident related compensation claims are increasing.

Investments in capital projects to save work years has been and will remain a key strategy for the future. For example, the almost $5 billion we invested in letter mail automation between 1987 and 1999 today has saved us almost $19 billion in cost avoidance to date. On the next page we discuss our successful letter automation program.

Letter Automation Success Story

We have worked hard to increase our productivity while delivering high-quality service. We've invested billions of dollars in automation, and that investment has paid significant dividends for postal customers in terms of reduced costs. For example, our strategy to automate the way we process letters has produced significant cost savings. Here's how we're doing this.



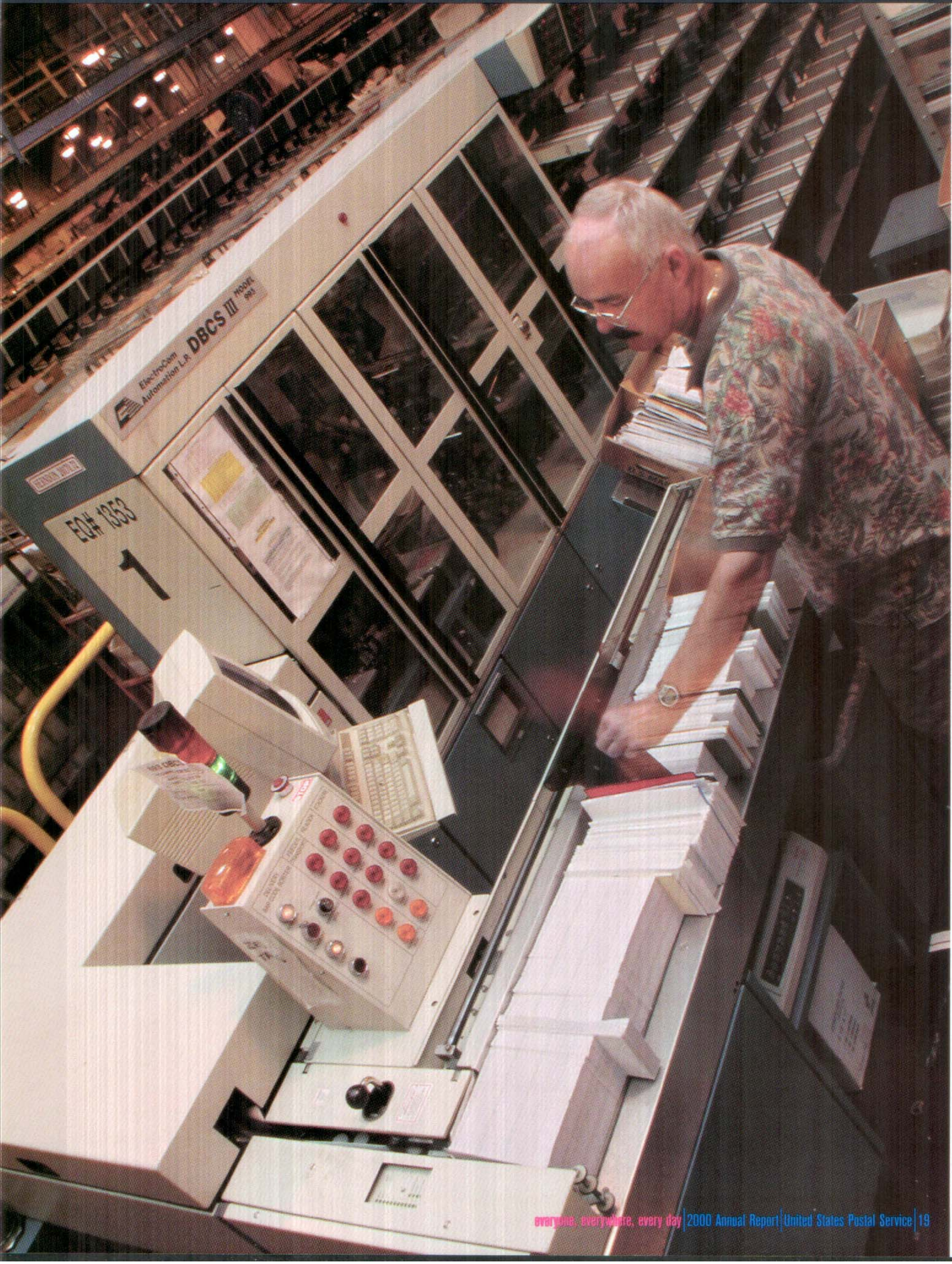
At first, letter automation was one letter at a time. Now it's 30,000 letters per hour.

When we introduced the ZIP+4 code and bar code, we also began to install the automated equipment that would use these innovations to move the mail. Using Optical Character Reader technology to read the ZIP+4 code and delivery address, and apply the appropriate bar code allows us to automatically sort the letter according to the mail carrier who will deliver it. For example, when you mail a letter in Seattle to your aunt in Chicago, our equipment will read the ZIP code and street address on your letter and place a bar code on the envelope. This bar code not only tells our automated equipment which mail carrier in Chicago will deliver your letter but also places it in the order in which it will be delivered on the carrier's route. Today, 89% of all letters are bar coded. Our goal, of course, is to get bar codes on all the letters we handle.

In addition to helping us move the mail more efficiently and to handle the growing volume of mail we must process each year, our success in automating the way we process letters has produced real cost savings. Since labor costs for distribution and sorting letters account for about 50% of the costs for processing them, we have focused on automating these functions. For example, from 1987 to 1999 we have accumulated cost savings equivalent to hundreds of millions of work hours in processing letters. In other words, without our progress in automating letter processing, we would have had to hire thousands more workers to move this mail.

Letter automation saved us millions of work hours. That is a cost avoidance of $19 billion since 1987.

Our investment in letter automation has produced a cumulative cost avoidance of $19 billion since 1987. In 2000 alone we had almost $3 billion in cost avoidance from our past investments in automation. And this trend will continue as our past investments pay increasing dividends in the form of lower costs. We must continue to make significant investments so that we will be able to control our costs in the future. Cost control today began with the investments we made yesterday; cost control tomorrow begins with the investments we make today.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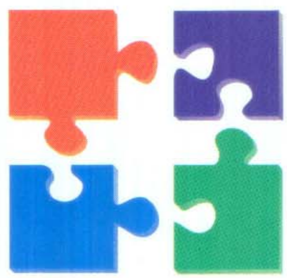
Management Discussion and Analysis (MD&A)

In addition to writing our MD&A in plain English, we present our analysis in a simple-to-understand format. First, there are four pieces of a puzzle throughout our MD&A. Each piece indicates an important concept about our financial condition. On pages 42 and 43 we put these pieces together so you can understand our complete financial condition. Second, we present our MD&A in an integrated format with four components: Operations, Capital, Financing and Other Issues. In the Operations section, we discuss the sources and amounts of our revenue, our productivity and the expenses we incur in running our operations. We explain how income from our operations is an important part of the cash flow that we use to finance our capital investments and our research and development efforts. In the Capital section, we discuss the investments we make to improve our efficiency. In our Financing section, we discuss how we manage our cash flow and provide the funds we need for those capital investments we cannot fund from our operating cash flow. Finally, in our Other Issues section, we discuss proposed postal legislation, the effects of classification and rate changes and environmental matters.

Outlook

We see 2001 as a year of opportunity and enormous challenge. With reasonable economic growth and the rate increase we requested, we see opportunities for our revenue to grow. However, our past experience has been that when we raise rates, our rate of growth in mail volume declines. The prospect of increasing inflation means we will have to achieve significant productivity gains to manage our costs, gains crucial to the continued affordability and viability of the mail. Finally, we face competition from new technologies. Yet we remain optimistic, because technology has also created opportunities.

Rate Case R2000-1 In January 2000, we filed an omnibus request with the Postal Rate Commission (PRC). They calculated the request to be a 6.0% rate increase across all classes of mail. We spent months preparing our proposal, which was then litigated by over 100 witnesses before the PRC over a 10-month period. The



Governors are now assessing the PRC's recommended decision, which was handed down on November 13, 2000. We expect to implement new rates in early January 2001, which means they will not be in effect during our biggest mailing season.

This lengthy process can seriously affect our financial condition. At the time we prepared R2000-1, we projected that by the time the new rates were effective, cumulative inflation since our last rate increase would be 4.8% as measured by the Consumer Price Index (CPI) and 7.3% as measured by the Employment Cost Index (ECI). ECI is an indicator of overall employee labor cost. Current projections are that CPI will be up 6.2% and ECI 8.7%. The PRC's recommended 4.6% rate increase is less than the inflationary pressures that drive our costs. Because labor is our major cost, an ECI increasing more rapidly than the rate increase approved by the PRC means that our financial condition is under stress.

Mail and the Economy Mail delivery has historically grown with the economy. However, the chart on the next page shows that over the past few years the economy has grown faster than mail volume. Over 90% of our mail volume is from businesses and other institutions. Thus, economic activity and trends in business practices fundamentally drive our volume. We expect moderate economic growth with total consumer spending growing 2.7% in real terms in 2001.

The New Economy Recent U.S. economic growth has been exceptionally strong, producing the longest economic expansion in U.S. history. Some see a "New Economy" driven by technological innovation that has led to the highest aggregate productivity growth in decades. Using computers, new software and the Internet, businesses operate more efficiently and better meet customer needs, which may offer us an expanded market for our expedited and package services. Consumption spending grew strongly in 2000 as households benefited from rising incomes, low unemployment and investment gains.

While many observers believe the New Economy has repealed the traditional business cycle, some analysts have concerns. The index of leading economic indicators peaked in March 2000, labor markets have tightened and capacity is strained. The Federal Reserve has raised interest rates. Historically, should economic growth slow, our financial condition would be affected.

Mail and This New Economy Growth in the new economy does not translate into mail volume growth to the same degree it did in the past. First-Class single piece mail growth has been shrinking, and Standard Mail (A) has grown more modestly than the extraordinary economic growth of the past five years would lead us to expect. Technology has certainly made communications markets more competitive and complex.

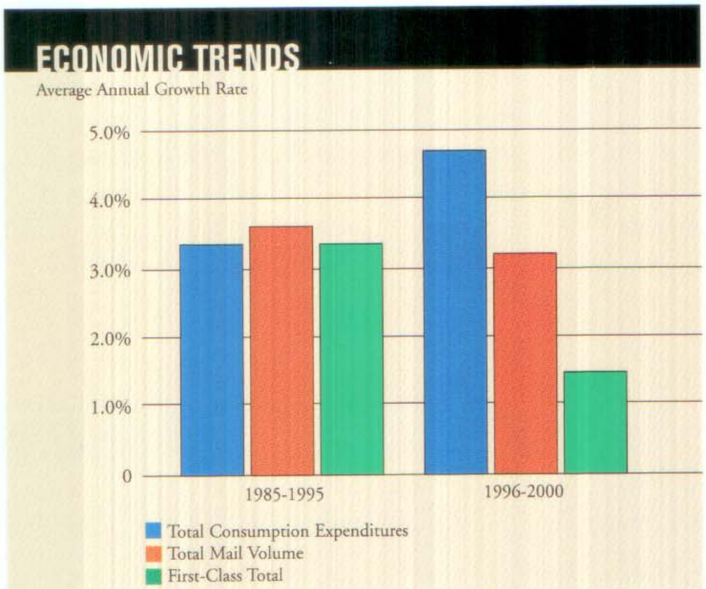
Advertisers are now rediscovering that their marketing strategies must include a mix of media to make their message effective. As the Internet provides new opportunities to gather and analyze information about individual consumers, advertisers will be able to target consumers more effectively using AdMail, especially compared to such advertising media as newspapers, television and radio.

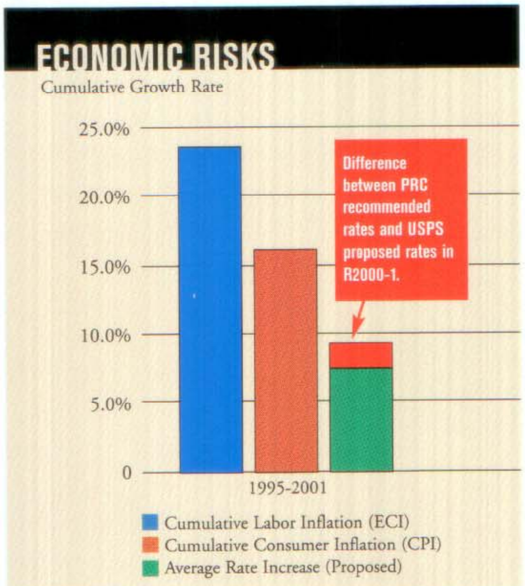
While the markets served by First-Class Mail are also growing—with strong growth in bills, statements and payments—our share of those markets may have peaked. Industry analysts vary greatly in their projections of how quickly households and businesses will transition to using the Internet to send bills or statements and to make payments. As more people have more and different kinds of financial accounts, such as IRAs, 401(k)s, mutual funds and credit cards, as well as savings and checking accounts, and as the strong growth of small and home-based businesses continues, invoices, bills, letters, small parcels and payments will be added to the mail delivery market.

Risks in the Economy We begin 2001 facing significant uncertainty in the economic environment. Inflation and labor contracts affect our costs, and we see considerable uncertainty for economic growth.

Inflation and Cost Uncertainty For 2001, we expect the consumer price index (CPI) to rise 2.8% and the employment cost index (ECI) an alarming 4.6%. Inflation is higher than we expected a year ago. Commodity prices rose significantly during 1999 and 2000, raising the warning that inflation could return to the global economy. Oil prices have risen from as low as $10 a barrel in 1998 to over $37 during the year. Three of our labor contracts come up for renewal in November 2000: the postal workers', the mail handlers' and the rural carriers' unions.

Our discussion in the MD&A represents our best estimate of the trends we know about, the trends we anticipate and the trends that we think are relevant to our future operations. However, actual results may be different from our estimates.





The trend in the new economy is that mail volume, and especially First-Class Mail volume, is no longer growing with the economy.

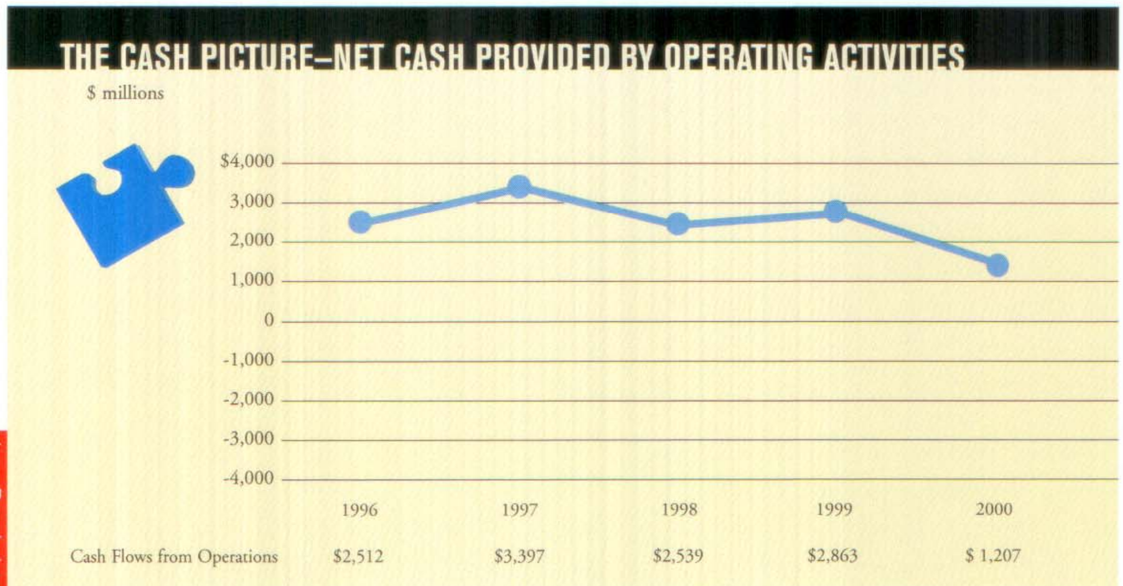
In addition, over the last two rate cycles, our prices have fallen well below consumer inflation and labor cost inflation.

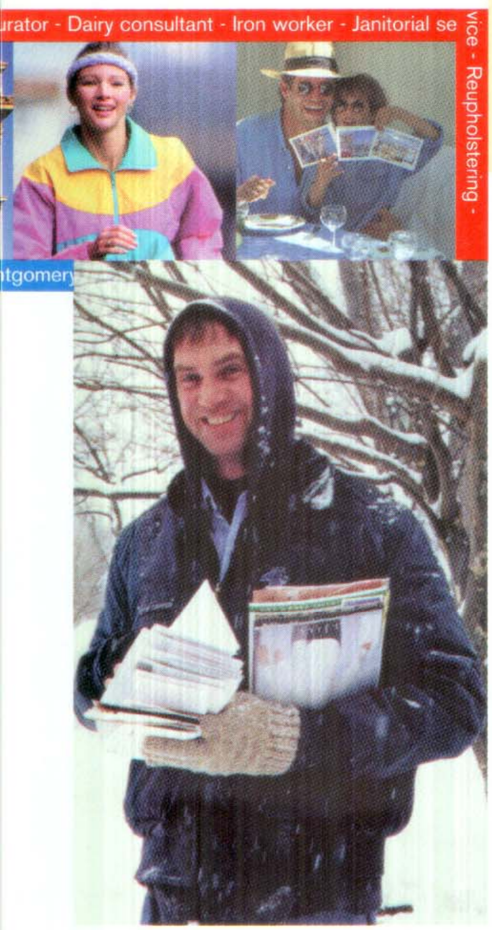
Operations

In this section, we give you the first piece of the puzzle and discuss our revenue and expenses for the year. We discuss in detail what each of the various products we offer contributed to our total revenue and how our revenue for 2000 compared to our revenue in the past two years. We also describe the rather lengthy and complicated process we must go through in order to bring the rates we are allowed to charge into line with the expenses we must pay. In addition to our revenue, we discuss our expenses for 2000 and how these expenses compared to our expenses in 1998 and 1999. For both our revenue and our expenses, we give our estimate of what we think they will be next year.

In the next chart we show our net cash provided by operations. This is part of our presentation on understanding our financial condition that is summarized on pages 42 and 43.

Lower cash from operations results primarily from higher costs.





Net Loss/Income

In 2000 we had a net loss of $199 million. This follows four years of net income that totaled $3,744 million. Put into context, this loss represents about one-half of one day's cash receipts. The chart above shows we continue to have a strong net cash flow from operations. This net cash flow did decrease this year, and our net loss was one of the causes.

When we were planning for this year, we knew that it was going to be a challenge, but we thought we could break even without a rate increase. However, revenue was almost $800 million below our estimate, rising fuel prices added $275 million in costs, increased claims and costs drove our Workers' Compensation costs to about $180 million more than we expected, and inflation added $58 million in unexpected wage increases. As this situation developed, management responded by concentrating even more on the basics. We came together as a team and reduced the one thing we could—work hours. Even as our work load increased, we raised our productivity. Simply put, we delivered an additional 6.2 billion pieces of mail, added 1.7 million delivery points and used 6,200 fewer work years than in 1999.

NET INCOME (LOSS)
$ millions

1998	1999	2000
$550	$363	$(199)

OPERATING REVENUE

Year	Operating Revenue	Increase Over Previous Year	Increase Over Previous Year (%)
1998	$60.1 billion	$1.9 billion	3.2%
1999	$62.7 billion	$2.6 billion	4.4%
2000	$64.5 billion	$1.8 billion	2.9%

Operating Revenue

The table above shows that the growth of our operating revenue declined compared to the two previous years. This was primarily a result of less First-Class Mail growth, shifting of mail between classes as mailers sought lower automation rates, and competition. The actual growth of 2.9% was less than what we anticipated when we wrote last year's report. Next year we expect steady revenue growth of approximately 5% reflecting the effect of our requested rate increase. We anticipate this revenue growth based on slight volume growth overall due to economic slow-down and the rate increase effect suppressing volume growth.

Our major sources of revenue are First-Class Mail, Priority Mail and Standard Mail (A), which together make up about 86% of our total revenue for 2000, or approximately the same percentage as 1999 and 1998. Although we expected First-Class Mail revenue to grow modestly in 2000, actual growth fell short of our expectations with an increase of just 1.7%.

Volume

Based on the rates we requested being implemented in January 2001 and forecasted economic indicators being accurate, our projection is that Standard Mail (A) will decline slightly, with First-Class Mail and Priority experiencing only slight growth. We also expect some growth in International Mail.

First-Class Mail

First-Class Mail had volume growth of 1.6% this year. We believe that future volume growth in First-Class will continue to be affected by movement by some large mailers to Standard Mail (A), as well as by the increasing availability and affordability of electronic alternatives to traditional mail.

Standard Mail (A)

Standard Mail (A), or advertising mail, grew by 5.1% in 2000. Mail continues to shift away from the nonautomation presort categories into automation presort as mailers take advantage of work-sharing discounts. Growth in Standard Mail (A) volume, while still

GROWTH IN REVENUE AND VOLUME

	Revenue			Volume		
	1998	1999	2000	1998	1999	2000
First-Class Mail	1.4%	3.2%	1.7%	0.8%	1.5%	1.6%
Standard Mail (A)	6.4%	5.4%	5.2%	6.8%	3.8%	5.1%
Priority Mail	8.6%	8.3%	6.7%	9.9%	1.3%	2.8%
Standard Mail (B)	7.8%	4.2%	4.6%	3.5%	1.9%	8.2%
Periodical Mail	0.2%	2.1%	2.6%	-0.9%	-0.4%	0.9%
International Mail	-0.9%	1.8%	1.8%	-6.2%	9.2%	6.7%

healthy, is less than in the past, due primarily to increased competition in the advertising market and the Internet.

Priority Mail

Priority Mail volume grew by 2.8%, relatively slow compared to recent growth. The growth rate would have been 3-4% higher were it not for the last rate change, which shifted 12- and 13-ounce mail from Priority Mail to First-Class Mail. This class of mail is also in the increasingly competitive expedited package market.

Standard Mail (B)

Growth in Standard Mail (B), primarily composed of parcel post, reached 8.2% in 2000. This is much higher than the growth in 1999 and is more in line with expectations.

Periodicals

This year Periodicals volume grew 0.9%. This reversed declines in the prior two years. We expect similar growth next year.

International Mail

International Mail volumes in 2000 grew 6.7%. International Priority Airmail more than doubled from its 1999 level, and International Express Mail grew by 7.5%.

Rate-Making Process

Until 1971, Congress set postage rates by law. Since revenue was subsidized by the taxpayers, rates did not cover the actual cost of operating the postal system. Since 1971, however, the Postal Reorganization Act has required the Postal Service to establish postal rates that cover the costs of operating the postal system. To achieve this alignment of rates with expenses, the Act established a rate-making process.

The rate-making process begins when management projects that current rates will not be adequate to meet our mandate of "covering costs" in the future. The Postal Service, upon concurrence with the Board of Governors, submits a request for a recommended decision on rate and fee changes to the Postal Rate Commission. (Like the Postal Service, the Commission is an independent establishment of the executive branch of the government.) As required by law, the request is accompanied by detailed rate proposals supported by extensive testimony and documentation.

The Commission holds public hearings, during which time such parties as mailers, competitors and consumer advocate groups

FORTUNE MAGAZINE'S GLOBAL 500

Revenue Ranking Global	Revenue Ranking U.S.		1999 Revenue* ($ in millions)	1999 Employees* Number	Employees* U.S. Rank In Top 10	Diversity U.S. Rank In Top 50
1	1	General Motors	$189,058	388,000	3	**
3	2	Wal-Mart Stores	$166,809	1,140,000	1	**
4	3	Exxon	$163,881	106,000	10	30
8	4	Ford Motor	$162,558	365,550	4	**
9	5	General Electric	$111,630	340,000	5	**
14	6	IBM	$ 87,548	307,401	6	**
16	7	Citigroup	$ 82,005	176,900	7	**
26	8	United States Postal Service	$ 62,726	905,766***	2	9
27	9	AT&T	$ 62,391	147,800	8	**
29	10	Philip Morris	$ 61,751	137,000	9	**

* Data used by Fortune was from 1999 Annual Reports.
** Not available or ranked
*** Career and noncareer employees

are authorized to question the Postal Service's proposals and submit their own testimony and proposals. At the conclusion of the hearings, the Commission sends its recommended decision to the Governors. The Governors may approve, reject, allow under protest or, under certain limited circumstances, modify the Commission's recommendations.

Although the Postal Reorganization Act requires the Commission to issue its recommended decision within 10 months of the filing of the Postal Service's request, the entire process—starting with preparing the necessary documentation to support the rate proposals and ending with implementing the new rates—takes approximately one and a half years. While this rate-making process has allowed us to bring revenue more in line with costs (when compared with having the rates set by Congress), it offers us only limited flexibility in responding quickly to changes in our costs and in the markets in which we compete.

Contribution

Contribution is the difference between revenue and volume-variable costs. As the term implies, volume-variable costs are those costs that vary directly or indirectly with changes in mail volume. For example, a high percentage of mail processing costs are considered volume-variable costs since changes in mail volume directly affect the number of hours clerks and mail handlers have to work. On the other hand, only a small fraction of postmaster salaries are considered volume-variable costs since these costs are, for the most part, unaffected by changes in mail volume. In 1999, the latest year available, volume-variable costs totaled more than $37 billion, or about 60% of total costs. The more than $25 billion remaining costs are non-volume-variable and must be borne, ultimately, by the combined revenue of all classes of mail.

Compensation and Benefits

Our personnel compensation and benefits grew $2.2 billion or 4.6% over 1999 due to overtime and premiums, and health and other benefits, in spite of the reduction of 6,200 work years. This compares to growth of 3.8% in 1999 and 4.0% in 1998. Base salaries alone increased more than $897 million in 2000, while overtime and premiums increased by $419 million or 10%. Our health benefits expenses were $265 million greater than last year, driven by premium increases of 8.7% for active employees and 11.3% for annuitants. We expect our health benefits expense to continue to grow for the foreseeable future. Since January 2000, all of our employees have been covered by the new health benefits formula that shifted about 2% of the insurance premium expense from employee to employer.

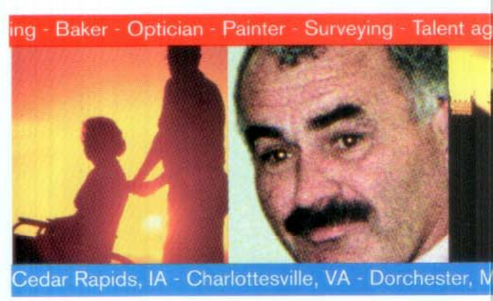
Our total retirement expenses grew by $428 million, and workers' compensation expense totaled $925 million, which is $311 million or 51% higher than last year.

GROWTH IN COMPENSATION AND BENEFITS

1998	1999	2000
4.0%	3.8%	4.6%

Based on a wage reopener clause in their 1995 agreement, the National Rural Letter Carriers' Association (NRLCA) agreed to accept the first-year 2.0% general increase specified in the American Postal Workers Union's and Mail Handlers' agreements as well as the continuation of the semi-annual cost of living adjustments. Our agreement with the NRLCA expired in November 1999, but in April 2000 the agreement was extended until November 20, 2000. Under the agreement there is a 1.4% pay increase and two cost of living adjustments. Beginning in 2001, the carriers will make the same contributions for health benefits as the other unions.

Our cost of living (COLA) payment in 2000 was $58 million higher than we had anticipated. We had planned on a March COLA increase



GROWTH IN TRANSPORTATION EXPENSES

1998	1999	2000
4.5%	1.4%	10.4%

of 11¢ per hour when in fact it was 17¢. Another COLA occurred in September, so it had little effect on our 2000 results, but it will affect next year's results.

As a result of binding arbitration, all letter carrier craft employees will be upgraded from Grade 5 to Grade 6 while maintaining the salary differential between the grades. We estimate that these salary upgrades will cost $267 million in 2001.

Most of our professional and management staff participate in the Postal Service's variable pay program. Next year, our nonbargaining employees are again eligible to participate in the merit pay and variable pay programs that base compensation on individual and group corporate performance aligned with the *CustomerPerfect!* process.

Transportation

Transportation expenses soared in 2000 due primarily to higher fuel prices. We estimate that higher fuel prices cost us approximately $275 million more than anticipated. This was in stark contrast to the declining rate of growth in transportation expenses for the prior three years. From 1998 to 1999, transportation expenses grew at a slower rate due to lower fuel prices and two service initiatives. First, the transportation of Priority Mail was increasingly handled by a contractor, thus shifting some expenses to the Other category. Second, to improve ontime delivery to our customers, we moved some mail from commercial air transportation to dedicated surface transportation. This change increased our control over the timeliness of mail transportation and reduced costs. In 2000 we continued these initiatives and changed more mail to dedicated surface transportation to increase our transportation timeliness even further.

We think that transportation costs in 2001 will remain in line with our costs for 2000. This forecast depends on several factors that are not under our control, such as the price of fuel, change in mail volume and change in mail weight. This forecast also depends on our continued efforts to increase productivity.

Retirement Expenses

Total retirement expense this year was $8.5 billion, an increase of $428 million or 5.3% compared to 1999. This follows increases of $405 million in 1999 and $241 million in 1998 compared to the previous years. Of this year's increase, $260 million resulted primarily from the settlement of collective bargaining agreements and labor arbitration settlements. Over $90 million of this year's increase was the result of the rising ceiling on maximum earnings subject to social security tax. Over $77 million of this year's increase was due to the cost of living adjustments (COLA) increasing based on the Consumer Price Index (CPI).

Most of our employees participate in one of three retirement programs, under the auspices of the federal government's Office of Personnel Management (OPM), based on the starting date of their employment. (Please see Note 6 of the Notes to Financial Statements for details.) These three programs are the Civil Service Retirement System (CSRS), the Dual CSRS/Social Security System (Dual) and the Federal Employees Retirement System (FERS). The CSRS and the Dual systems are now closed to new participants with all employees hired since 1983 participating in FERS.

Workers' Compensation

Like any business or government agency, we establish a budget of estimated expenses each year. As we have discussed earlier in this report, when expenses vary significantly from this plan, our financial results are affected. For this year we had budgeted or planned on workers' compensation costs of approximately $745 million, basing our budget on trends that we expected to continue. In fact, the actual results we discuss in the Notes to Financial Statements are 25% or about $180 million higher than our forecast.

A number of factors contributed to this unexpected increase. This year the Department of Labor accelerated their processing of claims and the rate of claims they approved. Because of these changes we had to revise our estimated future costs for all active cases. Other factors are trends that we expect will continue to affect workers' compensation costs in the future. There was an increase in the number of nontraumatic "occupational" injuries reported. In addition, average costs per medical claim increased by almost 14%, reflecting the resurgence of medical inflation that has also affected our health benefit premium costs. All of these factors acted in concert to increase our workers' compensation costs substantially and directly reduce our bottom-line results.

It is important to know that our employees are covered by the Federal Employees' Compensation Act (FECA), which is administered by the Department of Labor's Office of Workers' Compensation Programs, which makes all decisions regarding eligibility for benefits for injured workers. We pay all workers' compensation claims out of postal funds. Thus, our bottom line is directly affected every time an employee is injured.

We record as a liability the present value of all the future payments we expect to make to those employees receiving workers' compensation. At the end of 2000, we estimate our total liability for future workers' compensation costs at $5.8 billion. At the end of 1999, this liability was $5.5 billion. In 2000, we recorded $925 million in workers' compensation expense, compared to the $614 million we recorded in 1999. (See Note 2 of the Notes to Financial Statements for details.)

Economic Value Added

Economic Value Added (EVA) is one of the measures we use to evaluate our total financial performance. EVA is calculated after determining net operating income, and subtracting a charge for the capital we use to produce that income. Additionally, we apply an indexing factor that removes the impact of postal price increases and inflation. This gives us a true year-to-year comparison of our operating performance. Because it is measurable, we can clearly set goals and quantitatively measure improvement. We think EVA is important because it is the recognized yardstick used by many successful businesses. As many of these companies do, we use this measure as the basis of performance based pay for our management employees.

A strong EVA is a valuable indicator of overall financial success, but it does not guarantee pay for performance. EVA determines only the amount of the funds that may be used for performance awards. Actual payouts are determined by our success in fulfilling the targets we set in our Annual Performance Plan. We use a balanced set of nine targets that measure our service to customers, improvements for our employees and our financial performance. If we meet these targets, the Variable Pay Program rewards our performance. For example, if we meet the goal of delivering 93% of First-Class Overnight

Americans on the move

- 17 percent of Americans change addresses annually.
- 43 million people move annually.
- Average American moves 11 times in a lifetime.
- One of every six families moves each year.
- We processed 44 million changes of address in 2000.

(Forwarding is built into the price of a First-Class stamp.)

Yoga instructor - Lumber jack - Maid service - Hypno

OH - Rock Springs, WY - Fort Lauderdale, FL - Bate

Mail on time (measured by what we call the External First-Class Overnight score), we may receive a portion of the amount determined by EVA as eligible to be paid as a performance incentive. EVA is thus one part of our means for rewarding employees by tying compensation to measurable performance.

Expense Growth in 2001

We expect the cost pressures that made a major impact on our 2000 bottom line to continue. We estimate that our total expenses will increase 5.6% in 2001. The majority of this growth, however, will be due to inflation in labor cost or related to servicing an ever-expanding delivery network, which will grow by approximately 1.7 million new delivery points, the equivalent of over 3,400 new delivery routes.

Approximately two-thirds of our expense growth is driven by compensation and benefits, which will increase because of new labor contracts, health benefits and other pay-related expenses and not from a growth in work hours. Our planned 1.5% reduction in work hours in 2001 will be the second year in a row we will have reduced work hours. Including this decrease in work hours, we have built productivity improvements of over $1 billion into our 2001 plan. The major portion of the remaining expense growth is for nonpersonnel increases, including depreciation, interest expense, fuel cost, growth in programs such as eBusiness and the expansion of our infrastructure, such as our Point-of-Service (POS) ONE equipment.

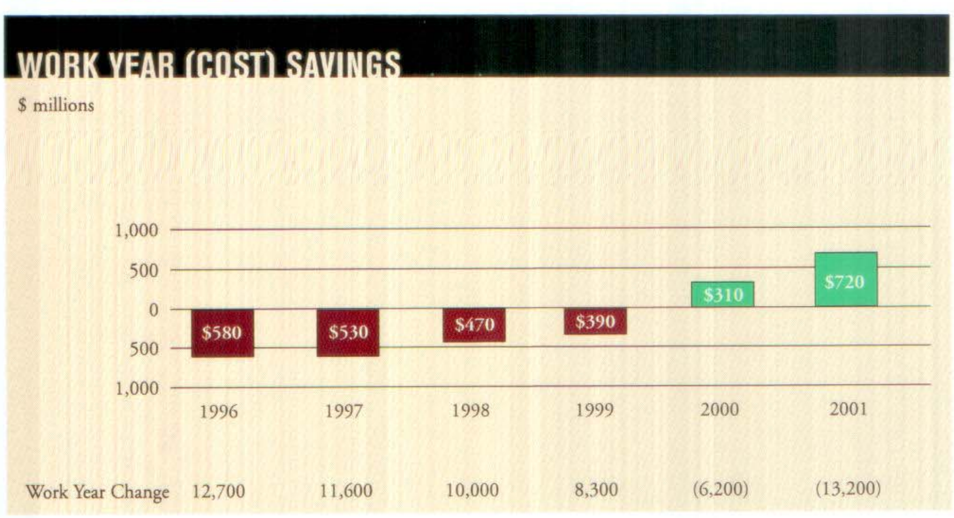
Productivity

Productivity is a measure of our internal efficiency. We use several measures to track productivity, including the Total Factor Productivity (TFP) measurement system. During 2000, our TFP improved by 2.5%, which is equivalent to reducing our expenses by $1.6 billion. This is the highest productivity growth we have achieved since 1993.

TFP tracks changes in productivity over time by measuring the changes between outputs and the resources used to produce those outputs. As our output measure, we use the mail volume we process and deliver, and the number of delivery points we serve. The TFP system takes into account workload factors such as size (e.g., letter, parcel, magazine), preparation (e.g., prebarcoding and presorting) and speed of service (e.g., Priority, First-Class and Standard Mail (A)). Our resources measure consists of all the labor, capital and purchased goods and services (materials) we use in providing our services and supporting our operations, including all our equipment, facilities, transportation, other nonpersonnel costs and indirect costs such as headquarters expenses. It is not uncommon for TFP growth to fluctuate from one year to another. Over the long run, a successful organization will average positive growth in productivity.

When compared to other years with strong positive TFP growth, our achievement in 2000 was significant. During the 1990s, our TFP grew an average of 0.2% annually, while our workload grew an average of 1.9% annually. In 2000 we achieved TFP growth of 2.5% in spite of a below average workload increase of just 1.9%. In previous years, our

As we increase productivity and reduce our number of work years, we will achieve cumulative savings of over $1 billion for 2000 and 2001. The red bars indicate added costs as a result of the increase in number of workyears. The green bars indicating a substantial savings.



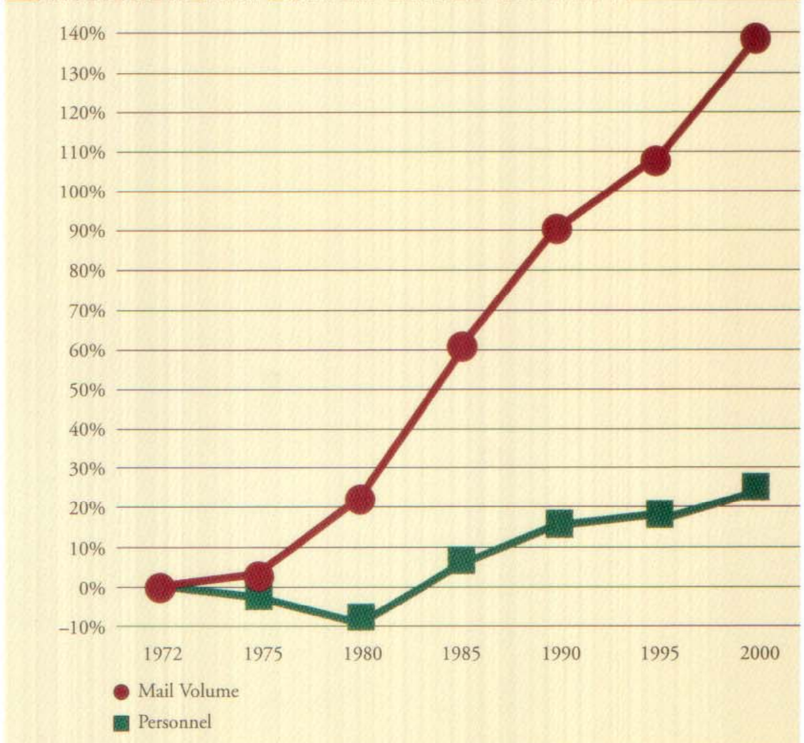
strong TFP growth was fueled largely by the growth in our workload. In 2000, we substantially reduced the resources we used, which led to a strong growth in productivity. During the 1990s, we laid the groundwork for future increases in productivity by investing heavily in upgrading our infrastructure and improving and expanding our use of automation and mechanization. In 2000 we saw the results of these investments.

Our productivity can be benchmarked against Multifactor Productivity (MFP), a productivity measure used for the nonfarm business sector of the economy, which is reported by the Bureau of Labor Statistics. Both TFP and MFP are best used to analyze long-term trends and are not effective as short-term measures or snapshots in time. From 1990 through 1999, MFP grew an average of 1.1% annually, while TFP grew an average of 0.2%. When benchmarking Postal Service TFP growth against MFP growth, we must take into account the impact of the worksharing discounts we offer mailers. With the worksharing discount, the mailer receives the prime productivity improvement opportunities that go with automation-compatible mail. Thus, our worksharing discounts improve the productivity of the economy as a whole but are not reflected in our TFP.

Turning Research and Development into Reality

Most of what we call research and development consists of testing the new products and technologies, as well as any modifications to existing products and technology that our suppliers have developed. Examples of projects for 2001 and beyond include one project involving software development for the National Directory Support System, which is the offline automation support for mail processing activities. Another program is extending the development of a prototype flats delivery sequencer into our operations. We are also

GROWTH IN MAIL VOLUME AND PERSONNEL



supporting the technology transfer of commercial robotics applications to our operations. And we are exploring low-cost alternatives for providing customers with convenient retail access to postal products and services.

On a percentage basis, it is clear that mail volume has increased dramatically while the percentage of workers has not.

We do conduct research and development in the field of optical character recognition simply because this technology is so essential for us, and we are the leader in the field. We have continued to improve our Remote Bar Coding System that is specifically designed to bar code mail not already bar coded, and which existing Optical Character Reading equipment cannot bar code. We have also continued to improve the technology we use to recognize handwritten addresses. Our research and development efforts focus on increasing our efficiency and improving customer service.

AFSM 100 Flat Sorter

We call a magazine, catalog, newspaper, advertising circular, and large envelopes a "flat," which is short for flat-size mail. Flats are oversize, bigger than letters, from 6 to 12 inches wide, 15 inches long, and 3/4-inch thick and weigh from one ounce to one pound, about the size of a Sunday newspaper. We deliver a lot of flats every day, over 51 billion in 2000. Moving flats quickly and economically is vital to you because you want that magazine delivered on time and to us because we want to provide the fastest, most economical service possible.

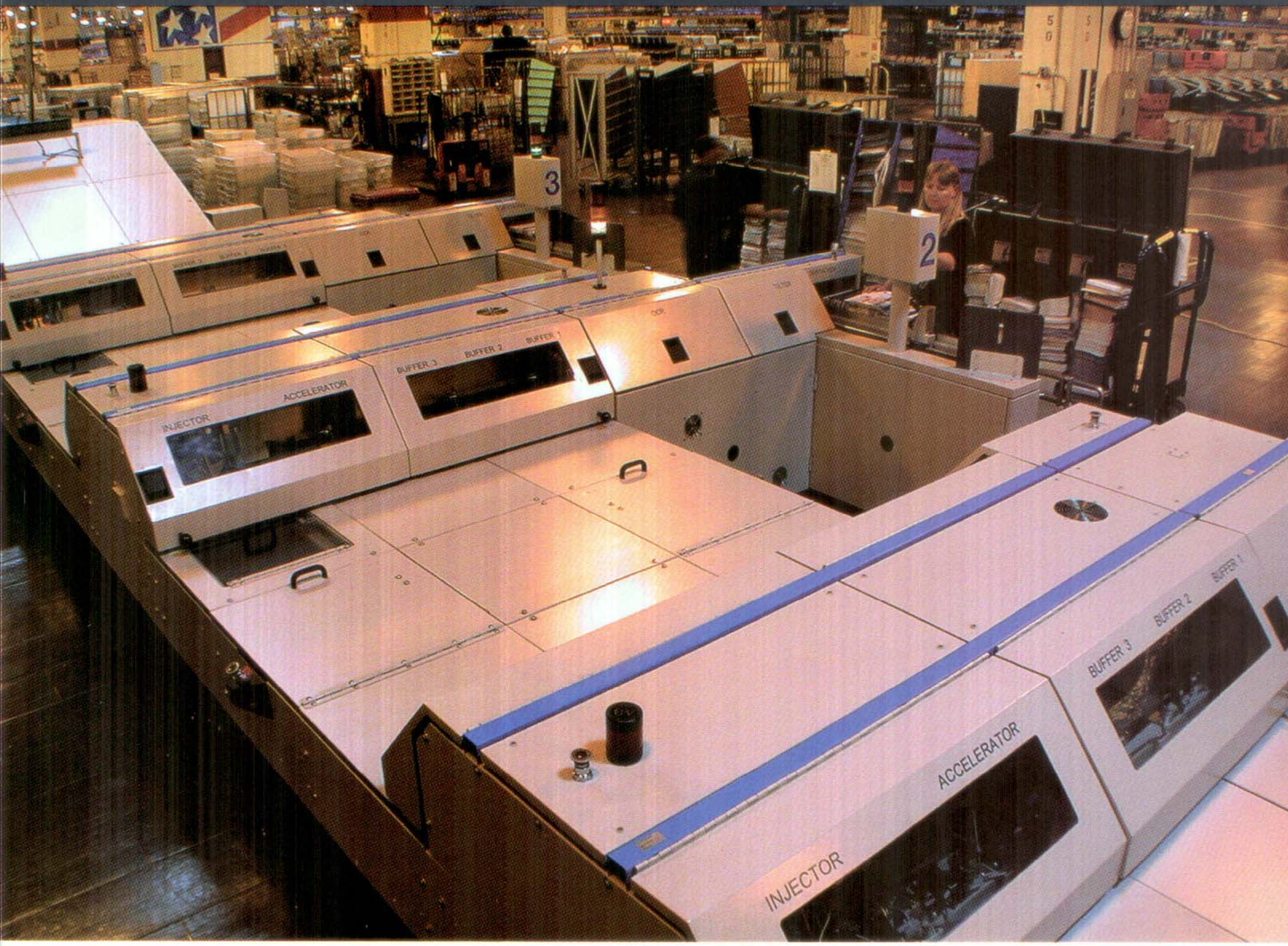
Our new Automated Flat Sorter Machine, or AFSM 100, is a state-of-the-art wonder of technology that processes mail almost three times faster than the machine that it replaces. Each of its three high-speed feeders can take in almost 6,000 flats per hour, which means the AFSM 100 can process over 17,000 flats per hour. When fully operational, each AFSM 100 is able to process more than 300,000 flats per day. This machine can also handle some polywrapped pieces, unlike its predecessor.

Using the latest optical character and bar code reader technology, the AFSM 100 reads the address on each piece of flat mail and then sorts it into one of 100 bins. When it can't read an address, it automatically sends an image of the piece to a nearby room where a postal worker reads the address and keys in the information that allows the piece to be sorted properly.

With the right tools, our employees can achieve record productivity.

We began deployment of the first 175 AFSM 100 machines in April 2000 and had 70 of them in operation by the end of the year. These initial machines are providing added capacity to our plants nationwide. We also are purchasing an additional 362 AFSM 100s as replacements for our older Model 881 flat sorters. All of these machines should be in operation by April 2002. With the AFSM 100, we can certainly process the mail faster and more efficiently, but just as importantly, we are able to handle it more accurately. This new technology allows us to control costs while delivering high quality service.

Such machines as the AFSM 100 take time and money to design and develop, but we have to continue our commitment to investing in new technology if we are to continue improving productivity. And it takes time for these investments to pay dividends in the form of increased productivity, but they do return much more than what we invest. To become more efficient in the future, we must invest in technology today. Without our past investments, we simply wouldn't be able to move as much mail as efficiently as we do today. Some of the machines that will make it possible for us to improve our efficiency in the future are listed on page 35.



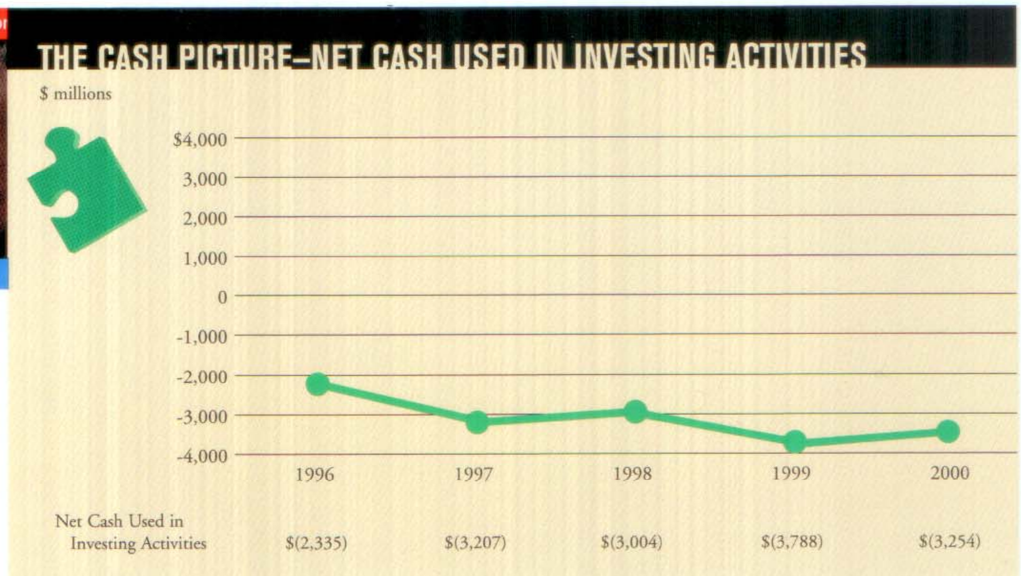
Helping Our Employees

Because the AFSM 100 can process so much mail so quickly, we designed a special worker-friendly, light-weight, ergo-cart that workers can use to bring flats to the machine's three automatic feeders. When loaded with up to 850 pounds of mail, the cart can be pushed with one hand by anyone with average strength. Using ergonomics, we designed a cart that helps those who operate the AFSM 100 to be as productive as possible while protecting their health and safety.

Capital

In this section we discuss the capital investments we made in 2000 and plan to make over the next five years in order to increase productivity, improve customer service and satisfaction and provide the groundwork for the development of new products in the future.

As part of our presentation on financial concepts, here is another part of the puzzle. It shows how we spend cash for improvements to our equipment, facilities and vehicles. On pages 42 and 43 we complete the puzzle and your understanding of our financial condition.



Cash outflows are made for assets to improve future operations.

2000 Capital Investments

During 2000, the capital plan was adjusted from $4 billion to $3.5 billion. This was the fifth consecutive year that we have had capital commitments of over $3 billion. This year our capital cash investments of $3.2 billion were spread across the following categories: $1.5 billion for construction and building purchases and improvements, almost $800 million for mail processing equipment, almost $500 million for vehicles and retail equipment and $400 million for postal support equipment.

During the year, we completed nine Board-approved projects. These projects, begun in prior years, represent a commitment totaling more than $486 million over the life of these projects. Of these nine projects, six were equipment projects, one was a facility project, the Metro Hub in Minneapolis, MN, and a project at our Mail Transport Equipment Service Centers.

The Board also approved a total of $1.6 billion for 20 new major capital investment projects. The largest of these projects to be completed in the future invests nearly $600 million into our flats automation program and over $100 million each for improvements to our delivery operations information system, our handwriting recognition efforts, our mixed delivery and collection vehicles and our bulk mailing centers. The approvals also included over $200 million in new or expanded facilities in California, Minnesota, New York, Nevada and Arizona.

Proposed 2001-2005 Capital Investment Plan

Our proposed 2001-2005 capital plan calls for capital investments of $3.6 billion in 2001 and $17.5 billion across five years. With its strong focus on technology, this plan will support our cost management efforts by promoting automation and modernization projects that affect the distribution, processing and delivery of the mail. This plan also includes programs that will improve the quality of customer service and promote revenue growth. In addition, we will continue to make investments in our infrastructure, so we can support the continuing growth in our delivery network, repair or replace aging assets and build the information technology network we need to develop new products and services while delivering the highest quality customer service.

To minimize borrowing, we fund projects from our cash flow from operations as much as possible. The CAPEX (capital expenditures) ratio graph illustrates the relationship between cash flow and capital expenditures. This ratio (which is calculated by dividing cash flow from operations by capital expenditures) measures the cash flow we have from operations to pay for new capital expenditures without increasing our debt or using cash on hand. When this indicator is below 100%, we must use debt to finance our capital expenditures. The Board of Governors must approve the capital budget each year. This approval represents a general concurrence with the capital plan. In addition, the Board requires that they approve projects costing greater than $10 million.

We subject all projects in the approved plan to a rigorous review and approval process that ensures they are fiscally sound and/or service oriented. We establish accountability for the results we expect the project to produce, and we analyze the project using Return on Investment methodology to ensure that our projections are accurate. Finally, when the project is completed, we conduct studies to determine whether we achieved our financial and operating goals.

By committing more resources to revenue-generating activities, this capital investment plan reflects our focus on high return on investment and infrastructure projects, as well as funding our e-Business initiatives, technological infrastructure and information platform projects. We estimate that our current portfolio of capital investment opportunities will produce a return on investment of approximately 16 to 18 percent over five years.

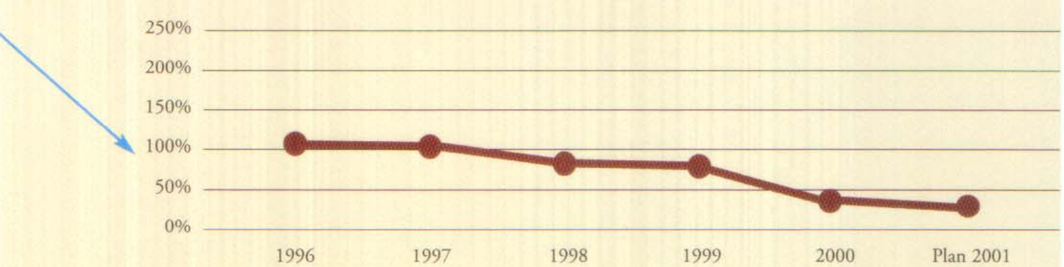
Equipment

We plan a total of $7.4 billion, or 42% of our capital spending plan, for equipment projects. Of this, $1.3 billion is for the 2001 capital plan. By automating an increasing number of functions, we will trim costs and improve performance. Automated equipment not only saves work hours and associated indirect costs but also delivers faster, higher-quality service. Our investments in automation and mechanization are essential to our goals of strengthening our financial viability by managing costs and increasing revenue. Automation also allows us to gather data that we can use in future information-based

As CAPEX goes below 100% we must borrow to finance our capital expenditures.

CASH FLOW TO CAPITAL EXPENDITURES RATIO (CAPEX)

$ millions



	1996	1997	1998	1999	2000	Plan 2001
Cash Flow from Operations	$2,512	$3,397	$2,539	$2,863	$1,207	$1,700
Capital Expenditures*	2,335	3,207	3,004	3,788	3,254	3,500

* Net cash flow from purchase and sale of property and equipment

services. For example, we will be able to integrate Tray Management Systems with the Next Generation Sorting Machine that utilizes optical character readers and video encoding to process over 17,000 pieces of mail per hour. We will continue to invest in the Delivery Bar Code Sorter Input/Output Subsystem (DIOSS), a universal modification kit that will be installed on existing Delivery Bar Code Sorters (DBCSs) to improve the capacity, speed and accuracy in which letter mail processing equipment reads, processes and sorts mail. We will install the Parcel Sorter Singulator Scan Induction System on all Bulk Mail Center parcel sorters to improve the capacity, speed or accuracy in which parcel mail processing equipment reads, processes and sorts mail. And our Automated Flat Sorting Machines (AFSM 100) will improve the processing of periodicals and oversized envelopes.

Facilities

Over five years, we will spend $5.6 billion, or 32% of the capital plan, in the expansion or construction of delivery/retail facilities, processing and distribution facilities and building improvements. For 2001, we will spend $1.1 billion on facilities. These improvements are necessary to keep up with increasing population, mail volume and changing delivery points, as well as to repair or replace aging facilities. However, we optimize the use of our present space to avoid new buildings whenever we can.

We design special tools, such as this cart, for easily moving large amounts of mail so employees can be more productive.

Infrastructure

Our five-year plan calls for $2.2 billion, or 13% of our capital spending, for infrastructure projects. Of this amount, $610 million is for 2001. Infrastructure consists primarily of the data collection and management systems that provide the day-to-day support necessary for our employees to perform their work. For example, our plan contains over 50 projects to improve our retail accounting, payroll data collection, productivity information management, International Dispatching systems and the network connecting our post offices.

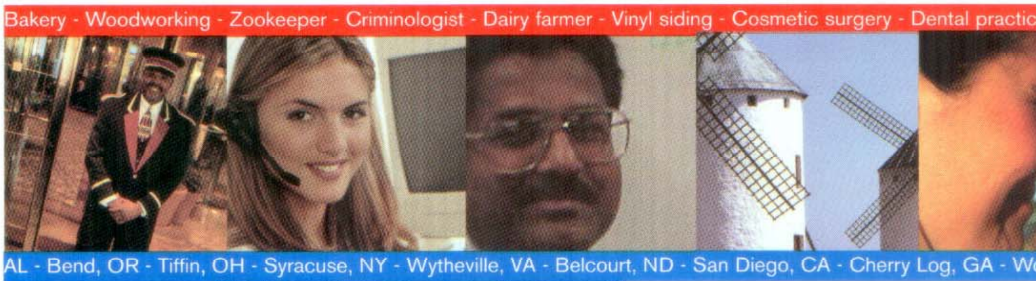
The five largest projects in our plan include the purchase of approximately 200 machines for our Mailing Evaluation Readability and Lookup INstrument (MERLIN) system, which reads addresses, verifies meter amounts, and weighs and measures the thickness of mail. Another project, the Surface-Air Management System, will incorporate all transportation information into one system. Our Structured Wiring project will provide a scalable, comprehensive, state-of-the-art data wiring system for all of our equipment and processes in our plants. We are also replacing our Delivery and Operations Information System, which is the computer software that provides our delivery supervisors with the data they need to make their daily workload decisions. And we are developing our PostalOne! System, which will allow business mailers to electronically interact with our systems.

Vehicles

We will invest $1.2 billion, or 7% of the five-year capital plan, in vehicles, including mixed delivery and collection vehicles, cargo vans and carrier route vans. Our award-winning alternate fuel program requires continual funding to comply with federal, state and local transportation regulations. For 2001, we will invest $335 million in new vehicles.

Retail

We will invest $791 million of our five-year capital plan to improve our retail services. Of this amount, we will invest $693 million to purchase and install 31,200 retail terminals in 9,500 facilities as part of the Point-of-Service (POS) ONE system. When completed, this new retail system will consist of 77,000 terminals in 20,000 retail facilities and will deliver quicker, more efficient consumer transactions while providing management with the information it needs to better serve our retail customers. We will also invest $41 million in our new automated postal centers that will provide our most popular services and products in completely automated facilities. In addition, we will purchase 1,000 new postal booklet stamp vending machines and 3,750 new stamp vending machines with debit and credit payment capability. For 2001, we will spend $236 million on our retail capabilities.



We are a labor-intensive business. So, the more we can invest in labor-saving equipment the better we can increase our efficiency, as well as improve our service and provide a safer working environment for our employees. Here are some of the investments we are making in innovative technology to provide the best possible service at the lowest possible cost, now and in the future.

ESTIMATED NEW EQUIPMENT SAVINGS ANALYSIS

Name	Description	Estimated Return on Investment	Estimated 10-Year Net Savings
Delivery Bar Code Sorter Additional Capacity	This upgrade module is added to existing machines so that mail that is now processed by hand can be processed by machine, and so that the machine can process more mail in fewer steps.	30.6%	$872.4 million
Delivery Bar Code Sorter Output Subsystems	This upgrade module is added to existing machines so that mail that is now processed by hand can be processed by machine, and so that the machine can process more mail in fewer steps.	21.5%	$108.5 million
Delivery Bar Code Sorter Phase V	This kit is added to the Delivery Bar Code Sorter so it can work with the Tray Management System, thus allowing the two systems to work together to process more mail automatically.	15.5%	$264.0 million
Flat Sorting Machines, Bar Code Reader	This upgrade module provides the Flat Mail Sorters with the capability to track individual mail pieces electronically, so customers can learn the status of delivered mail.	20.0%	$88.9 million
Identification Code Sort	This upgrade module makes it possible for mail with unreadable bar codes to stay in the automated mail stream, so that it's not rejected and then processed by hand.	31.0%	$207.0 million
Small Parcel and Bundle Sorters	Our next generation of this machine will automate both the feeding and sweeping functions, thus processing more mail in fewer work hours. The machine will also be equipped with improved optical character readers and bar code readers and provide a larger number of sortation bins without taking up more space. This combination of improvements will lead to faster processing time and improved accuracy.	25.9%	$136.9 million

Using Technology to Deliver

In 1971, we moved 87 billion pieces of mail. In 2000, we moved over 208 billion pieces of mail. Since 1971, the volume of mail we move has grown 139%, yet the number of postal workers needed to move all that mail has grown just over 23%. How do you move 208 billion pieces of mail (that's almost 668 million pieces of mail every day, including Saturdays), and move it quickly, economically and accurately without hiring thousands of additional workers? Well, you develop specialized technology to move this growing volume of mail, technology that helps you keep your costs down and your quality of service high. And you have to keep investing in technology, so you can continually improve your productivity.

From one flat at a time...

...to 17,000 per hour

Over the years, we have worked hard to develop the technology we need, not just to keep up with the growing volume of mail, but to move the mail as efficiently as possible. Today, we use over 15,000 pieces of automation equipment to move the mail. In addition to the new Automated Flat Sorting Machine (AFSM 100) described on page 30, we operate a wide range of machines that use the latest technology. And we're developing new machines and improvements to existing machines all the time so we can be even more efficient.

Here is just a small idea of how we use technology to move the mail. As thousands of letters pour into a processing center, workers feed them into a machine we call an Advanced Facer Canceler System with Input Subsystem. This machine arranges each envelope so that the address faces in the same direction. Then it cancels or postmarks the stamped mail and separates it into three groups: mail that already has a bar code, mail that has a machine printed address, and mail that has a handwritten address.

Prior to sorting, the Advanced Facer Canceler System lifts the image of each handwritten address and sends it to the Remote Bar Coding System where the image is used to develop and apply bar codes for use in subsequent sorting opeerations. Mail with a machine printed address is sent to a Multiline Optical Character Reader (MLOCR) machine that reads its address and applies the correct bar code. The image of any piece of mail rejected by the MLOCR is lifted and also sent to the Remote Bar Coding System for processing.

The images sent to the Remote Bar Coding System are initially processed by our Remote Computer Reader (RCR) equipment. It attempts to interpret the image and when successful, the letter can be bar coded on a sorter using the information provided by the RCR. Images rejected by this equipment are sent to remotely located workers who view the address images and key in the information required to print a bar code. Bar codes are subsequently printed on these letters as they are processed on our bar code sorters.

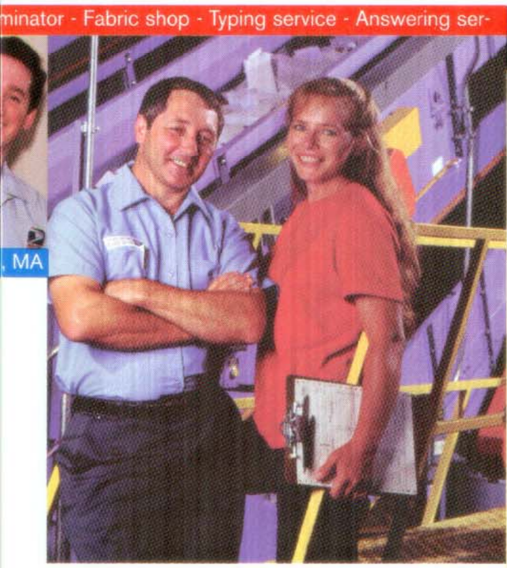
We have many other kinds of machines, each type designed to perform specific functions that were once performed by thousands of workers. All of these machines help us move the mountains of mail that pour into our thousands of post offices and acceptance points all over the continental United States, and in Alaska, Puerto Rico, Hawaii, Guam, the Virgin Islands and other places.

Every day we make sure that the hundreds of millions of pieces of mail you entrust to us get to where you want them to go, and we get them there as quickly and economically as possible. Without the investments in technology we've made in the past, we couldn't handle the volume of mail we do today. And that's why we need to invest in technology today: so we can handle the even greater volume of mail you'll entrust to us tomorrow.

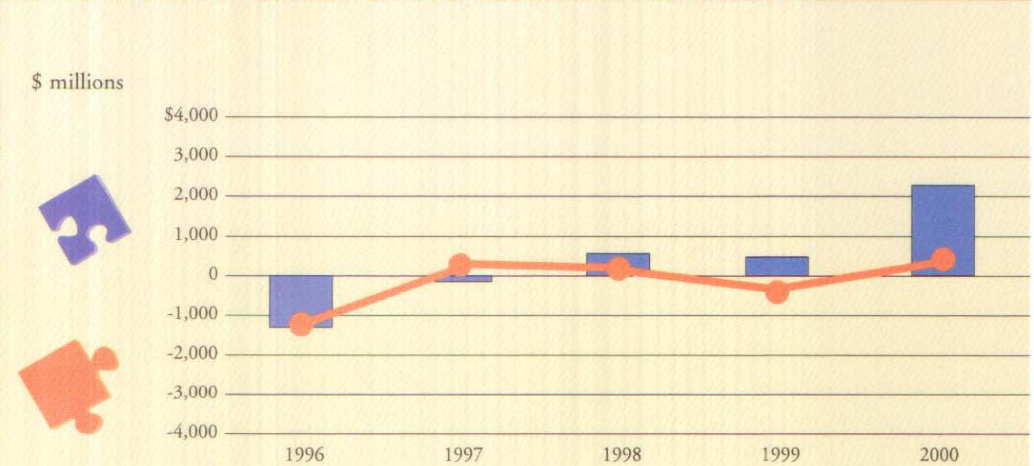

UNITED STATES POSTAL SERVICE
U.S. MAIL

Financing

In this section we discuss the last two parts of the puzzle: how we generate the cash we need to meet our operational expenses and how to fund the capital investments we must make if we are to improve our services and control expenses. We also discuss our cash management program, and our success at managing net interest expense. On pages 42 to 43 we complete the puzzle and your understanding of our financial condition.



THE CASH PICTURE–NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES



	1996	1997	1998	1999	2000
Net Cash from Financing Activities	$(1,361)	$(47)	$549	$ 496	$2,399
Change in Cash	(1,184)	143	84	(429)	352

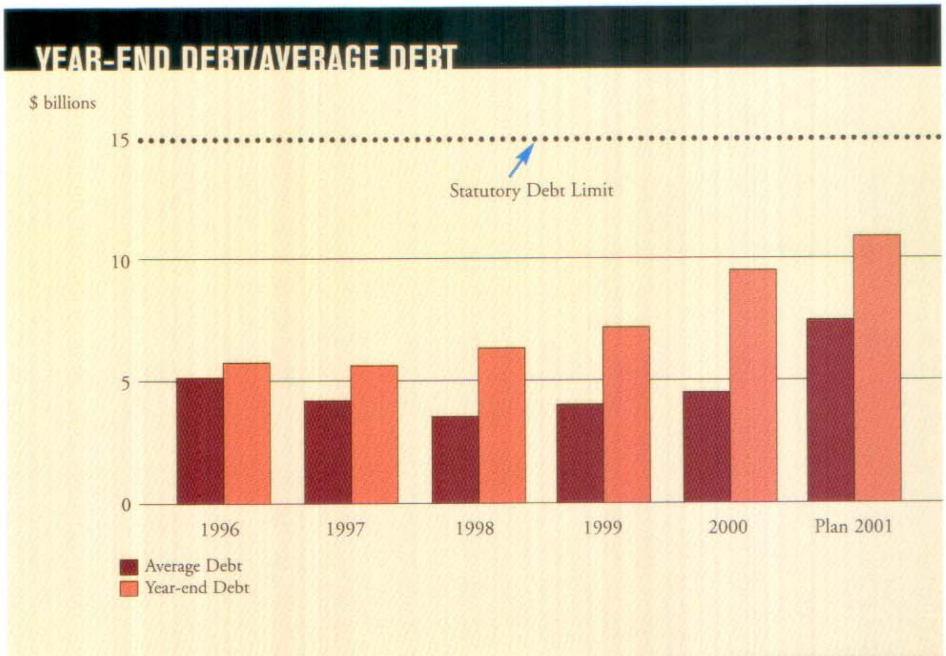
Cash Flow and Liquidity

We aim to finance as much of our capital program as we can using our cash flow, thus reducing the amount we have to borrow. By borrowing only as much as we need to, we manage our debt and our interest expense.

The amount we borrow is largely determined by the difference between our cash flow from operations and our capital cash outlays. Our capital cash outlays are the funds we invest back into the business for our capital investments in new facilities, new automation equipment and new services. As we discussed on page 22, our net cash flow decreased this year. This is important since it affects the amount of capital cash outlays we can make with internally generated funds. In 1996 and 1997 our cash flow from operations exceeded our capital cash outlays, and we used this excess along with cash to reduce our debt by $1.4 billion. Starting in 1998, our capital outlays exceeded our cash flow, so we increased our debt by $549 million in 1998, $496 million in 1999 and $2.4 billion in 2000.

We anticipate that our operating activities in 2001 combined with our immediate access to our loan facilities will provide us with sufficient cash flow to cover expected operations. However, we will need a net increase in our debt to help fund our five-year capital investment plan.

Liquidity is defined as the cash we have in the bank (the Postal Service Fund) and the amount of money we can borrow immediately if needed. We manage our cash so that we pay our obligations when they are due and use any excess to reduce debt or earn interest. An important part of our liquidity management program is negotiating solutions to our financing needs with the Department of the Treasury and its Federal Financing Bank, which is our lender. We designed this program to ensure that we have enough cash and borrowing ability to meet our daily obligations and invest in capital improvements, while we minimize our cash on hand and manage our debt.



We have worked closely with the Federal Financing Bank to put in place the tools we need to manage our cash more effectively, including call options, floating rate debt, real-time pricing, revolving credit lines, and notes that we can draw on with two days' notice with maturities ranging from a few days to 30 years. These financing tools give us flexibility and reduce the time it takes us to borrow funds while reducing market risk. If needed, the amount of money we can borrow immediately from the Federal Financing Bank is limited only by the amount of debt authorized by the Board of Governors and by statute.

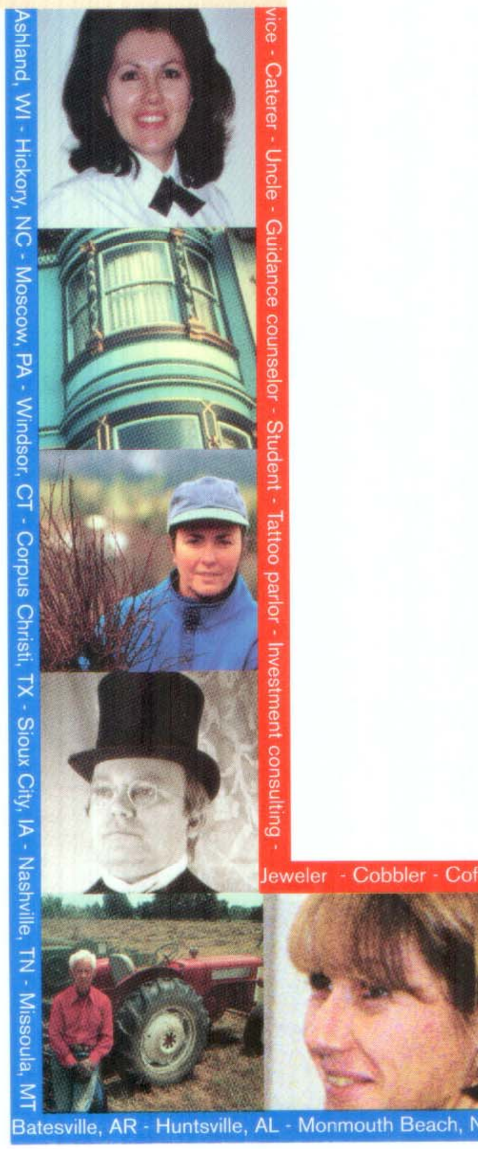
Debt Management

Our debt outstanding at the end of the fiscal year was $9.3 billion, an increase of $2.4 billion compared to 1999 but still below the peak of $9.9 billion we had in 1992. Our capital cash outlays of $3.3 billion exceeded our cash flow from operations of $1.2 billion. Additionally, we increased our cash on hand at the end of the year by $352 million.

Our strategy of managing cash and debt has not changed. We continue to minimize cash and debt on a daily basis. We are planning to increase year-end cash by $200 million in 2001, which combined with our modest cash cushion this year increases our cash management flexibility. Our financing need in any given year remains driven by the difference between cash flow from operations and capital expenditures.

At year end, our long-term debt was $2.5 billion, at a weighted average interest rate of 5.6% in comparison with $3.6 billion at 5.5% in 1999. We prefer to maintain a mix of fixed and floating rate debt because we believe that, over the long-term, variable or floating rate debt may provide more cost-effective financing than holding 100% fixed-rate debt. However, we strive for a favorable balance, and we will use fixed-rate debt when market opportunities arise or when we believe it reduces risk.

Our debt balance on the last day of our fiscal year represents our highest level of debt for the year. Our debt levels increase at year-end because of certain payment obligations that do not become due until then. As the year progresses, our cash flow is sufficiently strong to reduce our average debt balance substantially below our year-end level. Our year-end debt was $6.9 billion for 1999 and $9.3 billion for 2000. However, during the year our outstanding debt was as low as $3.1 billion. Because we have debt financing flexibility,



we can manage the fluctuations in our debt during the year.

Because we actively manage our credit lines, our average outstanding debt during the year was far less than the year-end balance. Our average outstanding debt increased to $4.7 billion in 2000 from $3.9 billion in 1999, and the interest we paid on our financing totaled $220 million in 2000 compared to $158 million in 1999.

We must follow certain statutory limits on our borrowing. First, our total outstanding debt cannot exceed $15 billion. The last time our debt limit was increased was in 1992. Second, the net increase in our debt each year is limited to $2 billion for capital purposes and $1 billion for operating purposes. For 2000 we borrowed $2 billion for capital expenditures and $400 million for operating expenses. We anticipate additional debt increases in 2001 and 2002.

DEBT/AVERAGE DEBT/INTEREST EXPENSE

	Year-End Debt $ billions	Average Debt $ billions	Interest Expense $ millions
1996	$5.9	$5.4	$368
1997	5.9	4.4	307
1998	6.4	3.2	167
1999	6.9	3.9	158
2000	9.3	4.7	220

Managing Net Interest Expense

Since our debt balance is larger than our cash balance, we are a net debtor. We cannot increase cash on hand without either borrowing or forgoing opportunities to reduce debt.

Net interest expense is the difference between interest expense and investment income. Our net interest expense is determined by the interaction of a number of variables including day-to-day cash flows, the behavior of interest rates and our debt management activities. Our efforts to manage net interest expense during the year's rising interest environment was a challenge.

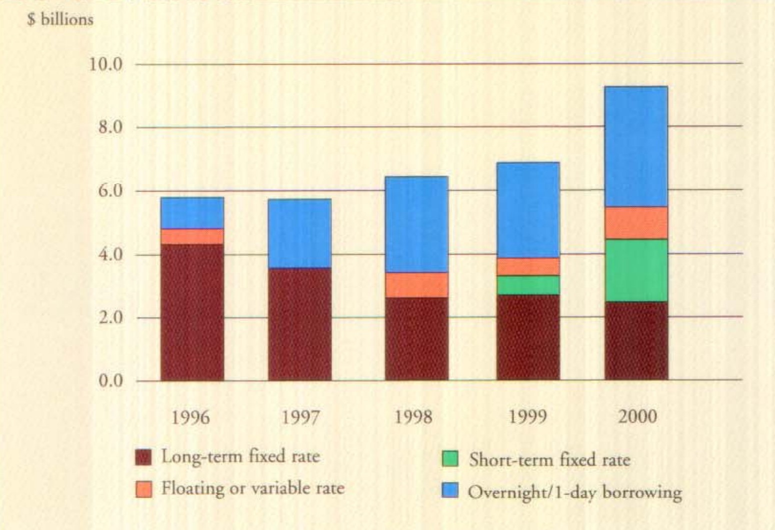
Since September 30, 1999, yields on short-term U.S. Treasury securities have risen between 90 and 135 basis points. Generally, short-term interest rates tend to be lower than long-term interest rates, but short-term rates are also more volatile. Borrowers are faced with the choice of paying lower interest expense over time, at the cost of more volatility and uncertainty, or paying stable but higher interest expense over time. We have chosen a position between the extremes. Our portfolio includes a mixture of long-term and short-term debt that is subject to changes in market interest rates. Furthermore, since our debt balance changes on a daily basis, so too does our mix of fixed and floating rate debt. The day that our debt outstanding reached its low for the year, we had 100% fixed rate debt. The same is true on most of the days that we had an overnight investment of excess cash.

We accept some volatility in interest expense in return for lower interest expense over time. We actively monitor the financial markets and when we see an opportunity, we move quickly to take advantage of it. For example, twice in 2000 we prepaid debt in transactions totaling $500 million, and we repurchased this debt at a discount.

Banking Relationships

During this year, we entered a new phase in our banking relationships. Previously, we reduced the number of banks we used from over 5,000 to 25 strategic banking partners with whom we negotiated multiyear contracts. We have begun rebidding expiring contracts with even more emphasis on competitive pricing and the highest levels of service. In

DEBT FLEXIBILITY



addition, we are realigning our national strategic banking relationships. Our goal is to accelerate by as much as one day, on average, the field deposits to the Postal Service Fund at the New York Federal Reserve Bank. In addition, we will continue to require the most advantageous pricing possible from the banks who provide us with the services we require.

We continue our commitment to, and participation in, the U.S. Department of the Treasury Minority Bank Program. We have funds, in the form of certificates of deposit, with 63 minority-owned banks this year. Each bank that participates in our program must maintain acceptable levels of solvency, liquidity, capitalization and loan portfolio quality.

Undeliverable Mail

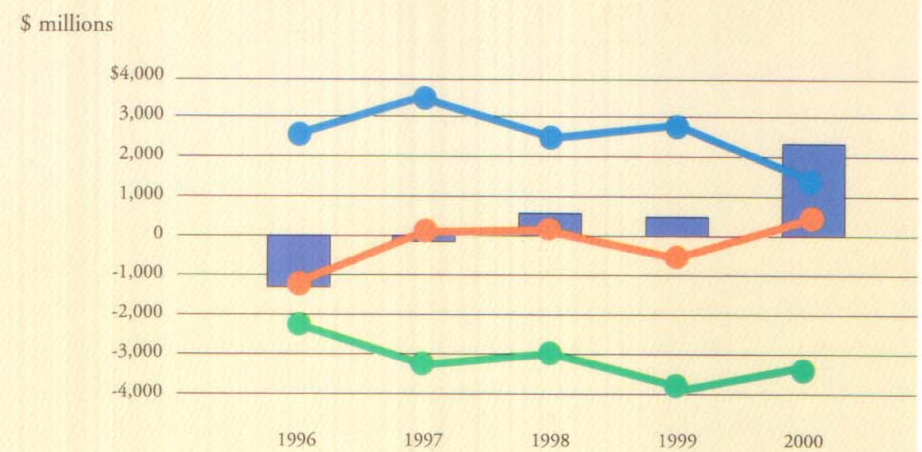
- **Undeliverable-as-addressed mail totaled 5.4 billion pieces in 2000.**
- **Additional average cost to handle per piece: 29 cents**
- **2.1 billion pieces (39%) were forwarded**
- **1.3 billion pieces (24%) were returned to sender**
- **2 billion pieces (37%) were treated as waste or recycled.**

Understanding Our Financial Condition

According to the American Institute of Certified Public Accountants, in order to understand a company's financial condition a shareholder must understand a company's Cash Flow Statement. As a government agency we too want you, our stakeholder, to understand our financial condition. This Statement is probably a puzzle if you're not an accountant, so we have presented throughout our MD&A the main concepts you need to understand in order to solve this puzzle. Here we bring together all the parts of the puzzle so you can see the complete picture and understand our "cash picture."

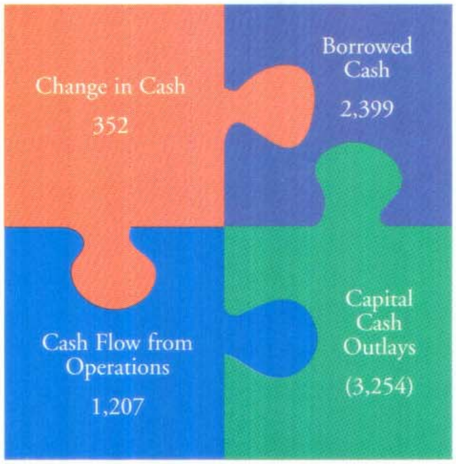
This chart shows our entire cash picture. Despite the large numbers, our cash management is no different than yours. Our family has income just like yours; we earn our paycheck one stamp at a time. And like you, we use our income to buy what we need: vehicles, buildings and equipment. If our paycheck isn't large enough, we use the cash we have in the bank, or we borrow what we need and pay it back with interest, just like you do.

THE CASH PICTURE



	1996	1997	1998	1999	2000
Operations	$2,512	$3,397	$2,539	$2,863	$1,207
Capital	(2,335)	(3,207)	(3,004)	(3,788)	(3,254)
Financing	(1,361)	(47)	549	496	2,399
Change in Cash	(1,184)	143	84	(429)	352

Safeguarding the nation's mail is an enormous task. With nearly 2,000 Postal Inspectors stationed throughout the United States, and a security force of more than 1,400 uniformed Postal Police Officers, the U.S. Postal Inspection Service shields Postal Service employees and customers from criminal attack, protects our nation's mail system from criminal misuse and ensures the privacy and sanctity of the U.S. mail.



In the first section of our MD&A we discuss our operations. We explain how net loss, one of the main components of cash flow from operations, affects our ability to invest in the future. This year we lost $199 million. That's why accountants lead off the Cash Flow Statement with net loss or income. We explain how our mail volume and our rates determine our revenue. We explain our major expenses and how hard we worked this year to reduce expenses.

Next we discuss our Capital investments of $3.337 billion. We explain our emphasis on investing in equipment to improve customer service and increase productivity.

Last, we discuss our financing. Our goal is simple: keep a prudent amount of cash on hand ($683 million, not even half of one payroll) and put the rest to work as fast as we can instead of letting it sit in a bank. We also try to keep the amount we borrow as low as possible ($2.399 billion) so we pay as little interest as possible. This year, because of our loss, a decrease in growth of revenue and increased labor rates, we increased our borrowing dramatically compared to recent years. Our only other option was to cut capital spending, a move that decreases our opportunity to improve our productivity in the future.

CONDENSED STATEMENT OF CASH FLOWS

For the Year Ended September 30, 2000

$ millions

Cash flows from operating activities:		
Net loss	$ (199)	Total revenue minus total expenses
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation	2,029	The non-cash charge we take because some of the useful life of our assets was used up during the year
Changes in assets and liabilities	(623)	
Net cash provided by operating activities	**1,207**	The change in the net book value of our assets and liabilities
Cash flows from investing activities:		
Purchase of property and equipment	(3,337)	
Proceeds from sale of property and equipment	83	
Net cash used by investing activities	**(3,254)**	The money we actually spent in 2000 to purchase vehicles and new automation equipment, and build or remodel our facilities.
Cash flows from financing activities:		
Proceeds from issuance of debt	5,550	
Payments made on debt	(3,151)	
Net cash provided by financing activities	**2,399**	The net amount we borrowed for the year
Net increase in cash and cash equivalents	352	
Cash and cash equivalents at beginning of year	331	
Cash and cash equivalents at end of year	**$ 683**	The cash we had on hand at the end of the year.

Other Issues

In this section we discuss those issues that lie outside the scope of our financial discussion. However, all of these issues are important to gain an understanding of our business, and they may significantly affect our financial condition. We discuss postal legislation, the effects of classification and rate changes and environmental matters.

Every day at no charge, we deliver to over 5,000 new addresses, which is the equivalent of adding a city the size of Chicago each year to our delivery system.

Recent Legislative Activity

In December 1999, the President signed S. 335, the Deceptive Mail Prevention and Enforcement Act (Public Law 106-168), which was sponsored by Senator Susan Collins, Chairwoman of the Senate Permanent Subcommittee on Investigations. This act establishes new regulations and penalties to curtail deceptive mailings featuring games of chance such as sweepstakes and provides us with additional tools to combat deceptive mailing practices by allowing the Postmaster General to issue administrative subpoenas.

In June 2000, identical bills were introduced in both chambers. Senators Thad Cochran, the Chairman, and Daniel Akaka, Ranking Minority Member of the Senate Subcommittee on International Security, Proliferation and Federal Services, cosponsored S.2686, followed by the introduction of Congressman Chaka Fattah's H.R. 4636. The Senate Subcommittee on International Security, Proliferation and Federal Services reported the Senate bill favorably to the full Senate by voice vote on September 27. Both bills would improve the process for establishing nonprofit postage rates.

In July 2000, President Clinton signed H.R. 4437, the Semipostal Authorization Act (Public Law 106-253), which was sponsored by Congressman John McHugh. This act allows us to create and sell, without Congressional approval, specialized postage stamps designed to raise money for causes we consider appropriate and in the national public interest. The act also extends the sale of the breast cancer stamp until July 29, 2002. The Breast Cancer Research stamp was the first semipostal stamp and the first U.S. stamp whose net proceeds above the cost of postage are designated for research organizations. As of September, the stamp had produced revenue of over $95 million, with more than $16.8 million in donations.

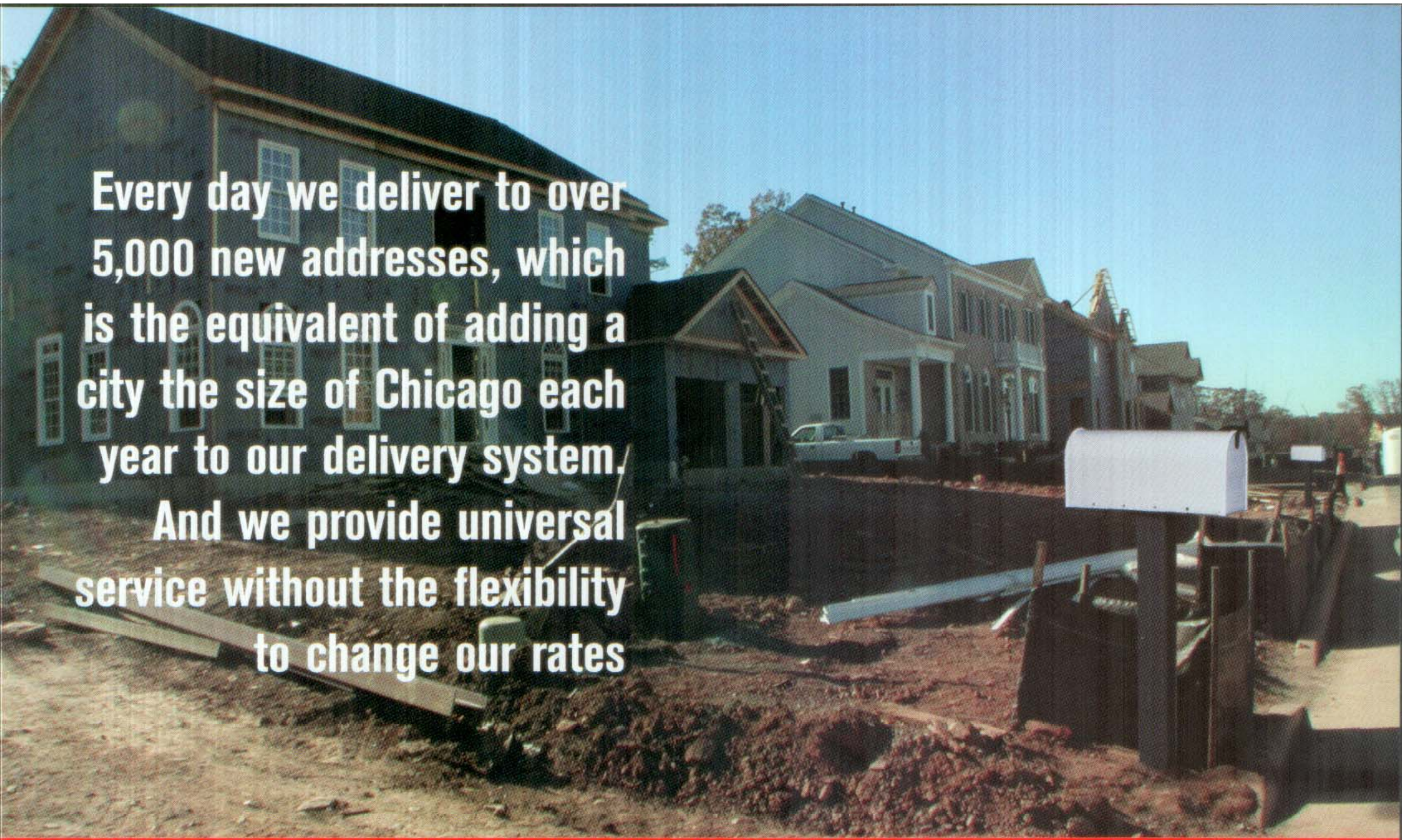
In September 2000, the President signed H.R. 4040, the Long-Term Care Security Act (Public Law 106-265), which was sponsored by Congressman Joe Scarborough. This law provides long-term care insurance to active and retired federal and postal employees, members of the uniformed services, and civilian and military retirees, if an employee or annuitant chooses to enroll.

Also in September 2000, the House passed the 2001 Treasury/Postal Service appropriations bill, but the Senate has yet to consider the measure. This bill would provide $29 million for revenue forgone repayment and a payment of $67 million for free mail for the blind and overseas voting, although the funds would not be available until October 1, 2001.

Classfication and Rate Changes

On January 12, 2000, our Board of Governors filed a request for a Postal Rate Commission (PRC) Recommended Decision on changes in rates and fees. At that time, we calculated our proposed overall change to be 6.4%, which included a one-cent (or 3%) increase in the current 33-cent basic First-Class rate. We estimated that our proposed increase would provide an additional $3.7 billion in revenue.

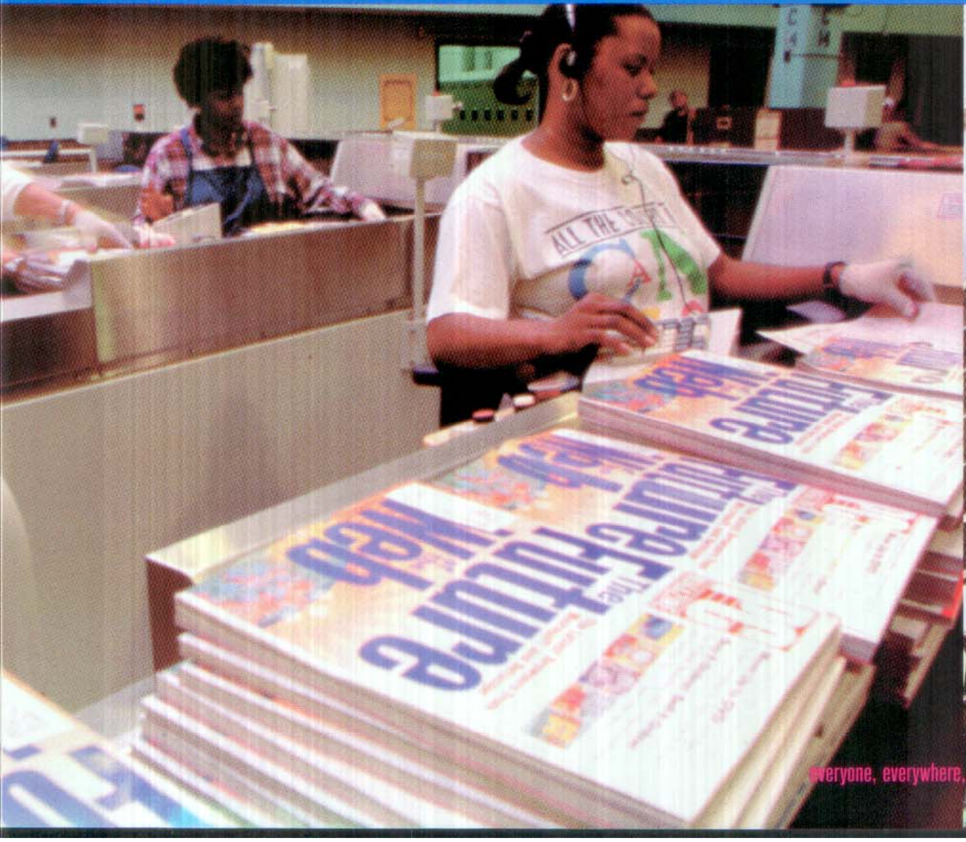
On September 27, 1999, our Board of Governors filed a case based on the "Experimental" rules, which allow us to test a new service on a limited basis. Under the existing classification schedule, mailers who include an enclosure in their periodicals are



Every day we deliver to over 5,000 new addresses, which is the equivalent of adding a city the size of Chicago each year to our delivery system. And we provide universal service without the flexibility to change our rates

gage repair - Mail order business - Emergency medical technician - Nursery - Health center - Office equipment rental - Storm windows - Tax preparation - Nurse - Office furniture

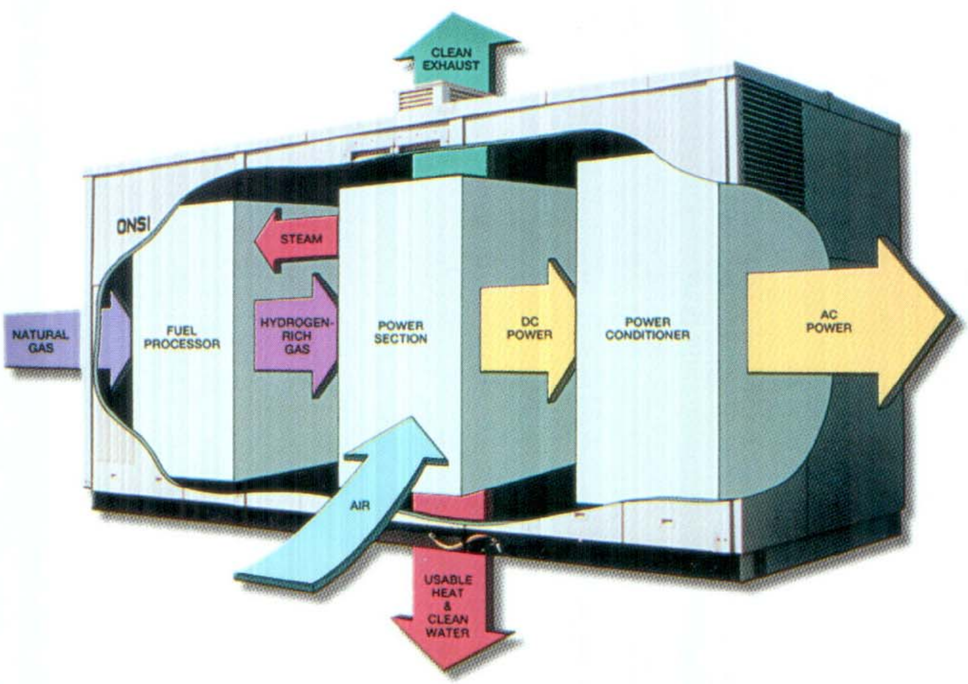
AZ - Grass Valley, CA - Truth or Consequences, NM - Valdosta, GA - Thibodaux, LA - Annapolis, MD - Block Island, RI - Grand Island, NE - Madison, WI - Presque Isle, ME - Ho



required to pay the Standard Mail (A) rate that would apply if the enclosure were mailed as a separate piece. In our proposal, mailers would pay a flat per-piece rate of 10 cents for the enclosure. After this filing, we reached an agreement with mailers and filed a stipulation and agreement with the Postal Rate Commission. On February 3, 2000, the Commission recommended the classification and fee based on this agreement. On February 26, we implemented the experimental classification, which will expire on February 20, 2002, unless it is made permanent or another experiment is put in its place.

On November 16, 1999, our Board of Governors filed an experimental case for a Mailing Online classification and fee schedule. On June 21, 2000, the Postal Rate Commission issued an Opinion and Recommended Decision which our Governors approved on August 7, 2000, with an implementation date of September 1, 2000. The experiment will last approximately three years. Mailing Online is a hybrid mail product that permits customers to create mailings electronically. With Mailing Online, customers design a document on their personal computers, send the document and a mailing list to us through our website, select their printing options and pay with a credit card. We then combine customer jobs and send them in batches to printing partners who create the mail pieces and give them to us for delivery.

The world's largest fuel cell system generates 1 gigawatt of power virtually pollution-free.



On June 9, 1999, the Continuity Shippers Association filed a complaint with the Postal Rate Commission arguing that the fee for Bulk Parcel Return Service was too high, because updated cost studies showed lower costs than originally estimated, and that the cost coverage should be lower than established. On April 14, 2000, the Commission recommended a lower fee but maintained the cost coverage. On June 15, 2000, our Governors rejected the Commission's recommended decision, noting that all costs change over time and that the Commission had failed to find the fee unlawful as required.

Environmental Matters

Our environmental policy focuses on protecting the environment, the health and safety of our employees and the communities in which we work. For us, concern with the environment is built into everything we do from the moment we think about doing it. Thus, environmental issues are an integral part of our planning from the beginning of any project to its completion. We believe that we can contribute to our bottom line by reducing pollution and operating costs.

We installed the world's largest commercial fuel cell system in Anchorage, Alaska. While generating one gigawatt of power, this system operates virtually pollution free, saving more than 200,000 pounds of air pollution and 5,500 tons of carbon dioxide from entering the atmosphere each year of operation.

We are purchasing 21,275 flexible fuel vehicles that operate on ethanol, unleaded gasoline or a combination of both. We also ordered 500 electric vehicles with an option for an additional 5,500.

We carry more mail to more people over a larger geographic area than any other country.

GLOBAL BARGAIN

Comparative value of a First-Class stamp as of September 30, 2000

	Stamp Price	Mail Volume (billions)	Geographic size (sq. miles)	Population	People per Sq. Mi.	Number of Retail Units	Employees
Mexico	**0.19**	0.9	756,066	98,552,776	130	9,432	26,294
Australia	**0.24**	4.5	2,967,893	18,613,087	6	4,425	34,961
Canada	**0.31**	9.6	3,849,674	30,675,398	8	18,600	63,900
United States	**0.33**	201.6	3,675,031	270,311,758	74	38,159	904,636
Italy	**0.36**	6.4	116,305	56,782,748	488	14,000	180,000
Great Britain	**0.40**	19.1	94,525	58,970,119	624	18,760	212,500
France	**0.40**	24.3	211,208	58,804,944	278	17,038	287,348
Germany	**0.50**	23.4	137,803	82,079,454	596	14,500	260,520
Switzerland	**0.52**	5.0	15,942	7,260,357	455	3,600	42,480
Japan	**0.74**	25.9	145,882	125,931,533	863	24,736	303,911

Source: Latest available data on the Universal Postal Union (UPU) is for 1998. (*www.upu.int*)

We developed a benign pressure-sensitive adhesive that, by Presidential Order, will be used throughout the Federal government. Previously, adhesives made paper unsuitable for recycling, but with our water-based adhesive the paper can be recycled. We use 15% of all paper adhesive, and federal and state governments use 25%. Once these agencies use this new adhesive, up to 40% of all adhesive paper that is now unfit for recycling can be recycled.

We built the first straw bale post office in Corrales, New Mexico. We combined the old-fashioned technique of using bales of straw as insulation between support beams combined with the latest energy-conservation systems and recycled materials. The result is a resource-efficient building that fits the environment of New Mexico while saving on heating and cooling costs.

Since 1996, we have received a number of awards for our efforts, including over 50 regional, state and local awards from environmental regulators, 8 Hammer awards from Vice President Gore's National Performance Review and 27 White House Closing the Circle awards. But the real credit for our successful environmental programs must go to our employees who are integrating environmental leadership into their daily activities. Awards are nice, but the best reward is implementing a successful environmental program that pays dividends for all of us and the communities in which we work and live.

We are involved in various litigation and have unresolved claims pending related to environmental matters. We believe that we have made adequate provision in our accounts for the amounts that may become due under these claims. We are of the opinion that such liability is not likely to be of significant importance in relation to our accounts.

How to Read Our Financial Statements

In our Management Discussion & Analysis, we give you a lot of information about how we operate, what we invest in and how we pay for those investments. We also tell you how we automated our mail processing operations, how hard we work to be environmentally friendly and how we improved our financial condition. Now we would like to help you read and understand our financial statements.

To help you understand this information, we've written it in plain English. But if you still don't understand some of the terms we use, you can find a guide to reading annual reports on the IBM website at www.ibm.com/FinancialGuide. Finally, we suggest that you compare us to other companies by looking at the annual reports companies publish on their corporate websites.

Now let's look at our financial statements.

1

Statement of Operations

Frequently referred to as an income statement, the Statement of Operations summarizes all revenue and expenses and ends up with the "Bottom Line," or net income or net loss.

1. Operating revenue: What we receive from our customers for the products and services we provide.

2. Operating expense: What we spend in order to produce our revenue, including everything from wages to health and life insurance benefits, workers' compensation, unemployment compensation, disability pay, transportation and many other items.

3. Interest expense and income: The income we earn from the money we have in bank accounts. Interest expense includes interest on money we borrow during the year.

(dollars in millions)	2000
Operating revenue—Note 7	$64,540
Operating expenses:	
Compensation and benefits—Notes 2, 3, and 6	49,532
Transportation	4,709
Other	8,751
Total operating expenses	62,992
Income from operations	1,548
Interest and investment income	41
Interest expense on deferred retirement—Note 6	(1,568)
Interest expense on borrowings	(220)
Net Loss	**$ (199)**

2

Statement of Changes in Net Capital Deficiency

1. Capital Contributions of U.S. Government: Since 1971, the federal government has invested $3.034 billion in the Postal Service.

2. Accumulated Losses Since Reorganization: Since 1971, our cumulative losses have been $3.680 billion.

3. Total Net Capital Deficiency: Since 1994, we've reduced our negative equity to $646 million.

(dollars in millions)	Year ended September 30, 2000 Capital Contributions of U.S. Government	Deficit Since Reorganization	Total Net Capital Deficiency
Balance, September 30, 1999	$3,034	$(3,481)	$(447)
Net Loss	—	(199)	(199)
Balance, September 30, 2000	**$3,034**	**$(3,680)**	**$ (646)**

3

Balance Sheet

The balance sheets give you our "financial condition," or a financial picture of us taken on September 30.

1. Assets: What we own, including all the buildings, land, machines, vehicles and everything else we use to move the mail, as well as the money others owe us.

2. Liabilities and net capital deficiency: What we owe on what we own, as well as money we owe others but haven't paid them yet.

3. The Board of Governors approves our 5-Year Capital Plan (2001-2005) totaling $17.5 billion. Emphasis is on cost management through technology, improvement of customer service and infrastructure investments.

(dollars in millions)	2000
Assets	
Current assets:	
Cash and cash equivalents—Note 2	$ 683
Other current assests	972
Total current assets	1,655
Other assets—Note 7	375
Total property and equipment, net	24,070
Deferred retirement costs—Note 6	32,183
Total Assets	$58,283
Liabilities and Net Capital Deficiency	
Current liabilities:	
Compensation and benefits	$ 5,295
Current portion of debt	6,814
Other current liabilities	6,168
Total current liabilities	18,277
Long-term debt, less current portion—Note 5	2,502
Other liabilities	38,150
Total Liabilities	58,929
Total Net Capital Deficiency	(646)
Total Liabilities and Net Capital Deficiency	$58,283

4

Statement of Cash Flows

1. Net cash provided by operating activities: What we received in cash during the year.

2. Purchase of property and equipment: The money we spend on plant and equipment so we can reduce costs and better serve our customers.

3. Cash flows from financing activities: The cash we borrow, and the cash we use to pay back money we borrowed..

(dollars in millions)	2000
Cash flows from operating activities:	
Net loss	$ (199)
Adjustments to reconcile net income to net cash provided by operating activities	1,406
Net cash provided by operating activities	1,207
Cash flows from investing activities:	
Purchase of property and equipment	(3,337)
Proceeds from sale of property and equipment	83
Net cash used in investing activities	(3,254)
Cash flows from financing activities:	
Issuance of debt	5,550
Payments on debt	(3,151)
Net cash provided by financing activities	2,399
Net increase in cash and cash equivalents	352
Cash and cash equivalents at beginning of year	331
Cash and cash equivalents at end of year	$ 683

Management responded to our revenue shortfall, and our employees delivered by curtailing expenses.

Statements of Operations

(dollars in millions)	2000	1999	1998
		Year ended September 30,	
Operating revenue—Note 7	**$64,540**	$62,726	$60,072
Operating expenses:			
Compensation and benefits—Notes 2, 3, and 6	**49,532**	47,333	45,596
Transportation	**4,709**	4,267	4,207
Other	**8,751**	9,042	7,983
Total operating expenses	**62,992**	60,642	57,786
Income from operations	**1,548**	2,084	2,286
Interest and investment income	**41**	29	44
Interest expense on deferred retirement liabilities—Note 6	**(1,568)**	(1,592)	(1,613)
Interest expense on borrowings	**(220)**	(158)	(167)
Net (Loss) Income	**$ (199)**	$ 363	$ 550

See accompanying notes to financial statements.

Balance Sheets

(dollars in millions)	September 30, 2000	1999
Assets		
Current assets:		
Cash and cash equivalents—Note 2	**$ 683**	$ 331
Receivables:		
Foreign countries	**349**	337
U.S. government	**134**	149
Consignment	**55**	58
Other	**158**	147
	696	691
Less allowances	**107**	113
Total receivables, net	**589**	578
Supplies, advances and prepayments	**383**	387
Total current assets	**1,655**	1,296
Other assets, principally revenue forgone appropriations receivable—Note 7	**375**	376
Property and equipment, at cost:		
Buildings	**17,685**	16,513
Equipment	**13,973**	12,421
Land	**2,534**	2,407
Leasehold improvements	**1,133**	1,019
	35,325	32,360
Less allowances for depreciation and amortization	**13,644**	12,143
	21,681	20,217
Construction in progress	**2,389**	2,623
Total property and equipment, net	**24,070**	22,840
Deferred retirement costs—Note 6	**32,183**	31,497
Total Assets	**$58,283**	**$56,009**

See accompanying notes to financial statements.

Balance Sheets (continued)

(dollars in millions)	September 30, 2000	1999
Liabilities and Net Capital Deficiency		
Current liabilities:		
Compensation and benefits	**$ 5,295**	$ 5,919
Estimated prepaid postage	**1,594**	1,628
Payables and accrued expenses:		
Foreign countries	**439**	527
U.S. government	**150**	164
Other	**1,300**	973
Total payables and accrued expenses	**1,889**	1,664
Prepaid box rentals, permit and metered mail	**1,969**	2,049
Outstanding postal money orders	**716**	813
Current portion of long-term debt	**6,814**	3,363
Total current liabilities	**18,277**	15,436
Long-term debt, less current portion—Note 5	**2,502**	3,554
Other liabilities:		
Amounts payable for deferred retirement benefits—Note 6	**30,212**	29,685
Workers' compensation costs—Note 2	**5,029**	4,901
Employees' accumulated leave	**2,090**	2,041
Other	**819**	839
Total other liabilities	**38,150**	37,466
Commitments and contingencies—Notes 8 and 9		
Total Liabilities	**58,929**	56,456
Net capital deficiency:		
Capital contributions of the U.S. government	**3,034**	3,034
Deficit since reorganization	**(3,680)**	(3,481)
Total Net Capital Deficiency	**(646)**	(447)
Total Liabilities and Net Capital Deficiency	**$58,283**	$56,009

See accompanying notes to financial statements.

Statements of Changes in Net Capital Deficienc

Years ended September 30, 2000, 1999, and 1998

(dollars in millions)	Capital Contributions of U.S. Government	Deficit Since Reorganization	Total Net Capital Deficiency
Balance, September 30, 1997	$3,034	$(4,394)	$(1,360)
Net Income	—	550	550
Balance, September 30, 1998	3,034	(3,844)	(810)
Net Income	—	363	363
Balance, September 30, 1999	3,034	(3,481)	(447)
Net Loss	—	(199)	(199)
Balance, September 30, 2000	**$3,034**	**$(3,680)**	**$ (646)**

See accompanying notes to financial statements.

Statements of Cash Flows

(dollars in millions)	2000	Year ended September 30, 1999	1998
Cash flows from operating activities:			
Net (loss) income	**$(199)**	$ 363	$ 550
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	**2,029**	1,795	1,579
(Gain) loss on disposals of property and equipment, net	**(5)**	(55)	7
Decrease (increase) in other assets, principally revenue forgone appropriations receivable	**1**	3	(7)
Increase in USPS workers' compensation	**254**	19	195
Decrease in Post Office Department workers' compensation	**(17)**	(21)	(27)
Decrease in retroactive assessments payable to the U.S. government	**—**	—	(331)
Increase in employees' accumulated leave	**49**	82	101
(Decrease) increase in other liabilities	**(20)**	207	143
Changes in current assets and liabilities:			
(Increase) decrease in receivables, net	**(11)**	207	(113)
Decrease (increase) in supplies, advances and prepayments	**4**	(39)	40
(Decrease) increase in compensation and benefits	**(892)**	503	451
Decrease in estimated prepaid postage	**(34)**	(45)	(70)
Increase (decrease) in payables and accrued expenses	**225**	(371)	(62)
(Decrease) increase in prepaid box rentals, permit and metered mail	**(80)**	94	31
(Decrease) increase in outstanding postal money orders	**(97)**	121	52
Net cash provided by operating activities	**1,207**	2,863	2,539
Cash flows from investing activities:			
Purchase of U.S. government securities, available-for-sale	**—**	—	(620)
Proceeds from sale of U.S. government securities, available-for-sale	**—**	—	622
Purchase of property and equipment	**(3,337)**	(3,917)	(3,055)
Proceeds from sale of property and equipment	**83**	129	49
Net cash used in investing activities	**(3,254)**	(3,788)	(3,004)
Cash flows from financing activities:			
Issuance of debt	**5,550**	4,129	5,696
Payments on debt	**(3,151)**	(3,633)	(5,147)
Net cash provided by financing activities	**2,399**	496	549
Net increase (decrease) in cash and cash equivalents	**352**	(429)	84
Cash and cash equivalents at beginning of year	**331**	760	676
Cash and cash equivalents at end of year	**$ 683**	$ 331	$ 760

See accompanying notes to financial statements.

Notes to the Financial Statements

1 Description of Business

Nature of Operations

The United States Postal Service (Postal Service) provides mail service to the public, offering a variety of classes of mail services without discrimination among its many customers. This means that within each class of mail our price does not vary by customer for the levels of service we provide. This fulfills our legal mandate to offer universal services at a fair price. Our primary lines of business are First Class Mail, Standard Mail (A) and Priority Mail. The principal markets for these services are the communications, distribution and delivery, advertising and retail markets. Our products are distributed through our more than 38,000 post offices and a large network of consignees. As in the past, we continue to conduct our significant operations primarily in the domestic market, with our international operations representing less than 3% of our total revenue.

Our labor force is primarily represented by the American Postal Workers Union, National Association of Letter Carriers, National Postal Mail Handlers Union and National Rural Letter Carriers Association. Almost 90% of our career employees are covered by collective bargaining agreements. Three of our largest contracts representing 61% of our career employees expire November 20, 2000. Negotiations have begun between management and the unions, and agreements are expected during fiscal year 2001.

Postal Reorganization

The Postal Service commenced operations on July 1, 1971, in accordance with the provisions of the Postal Reorganization Act (the Act). The equity that the U.S. government held in the former Post Office Department became the initial capital of the Postal Service. The Postal Service valued the assets of the former Post Office Department at original cost less accumulated depreciation. The initial transfer of assets and subsequent cash contributions totaled approximately $3 billion. The U.S. government remained responsible for all the liabilities attributable to operations of the former Post Office Department. However, under the Balanced Budget Act of 1997, the remaining liability for certain Post Office Department costs was transferred to the Postal Service.

Price Setting Process

Since 1971, the Act has required the Postal Service to establish prices that cover the costs of operating the postal system. The Act established the independent Postal Rate Commission with oversight responsibility for mail prices, subject to approval by the Governors of the Postal Service. The Act provides for the recovery of operating losses through future rate increases.

2 Summary of Significant Accounting Policies

Basis of Accounting and Use of Estimates

We maintain our accounting records and prepare our financial statements on the accrual basis of accounting. This basis conforms to generally accepted accounting principles. Following these principles, we made estimates and assumptions that affect the amounts we report in the financial statements and notes. Actual results may differ from our estimates.

Cash Equivalents

Cash equivalents are securities that mature within 90 days or less from the date we buy them.

Current Values of Financial Instruments

The current value of our debt is what it would cost us to pay off the debt if we used the current yield on equivalent U.S. Treasury debt.

Supplies, Advances & Prepayments

Supplies, advances and prepayments are primarily composed of our inventories of supplies, motor vehicle parts, repairable parts for mail processing equipment, and advances to employees for annual leave. We value our inventories at the lower of average cost or current market price. Total inventories amounted to $173 million at the end of 2000 and $172 million at the end of 1999.

Property and Equipment

We record property and equipment at what it costs us to acquire the assets, including the interest we pay on the money we borrow to pay for the construction of major capital additions. This interest amounted to $49 million in 2000, $59 million in 1999 and $44 million in 1998.

We depreciate buildings and equipment over their estimated useful lives, which range from 3 to 40 years, using the straight-line method. We amortize leasehold improvements over the period of the lease or the useful life of the improvement, whichever time is shorter.

Estimated Prepaid Postage

This is the amount of cash we estimate that we collected by the end of the year for services that we will perform in the following year.

Compensation and Benefits Payable

This is the salaries and benefits we owe to current and retired employees, including the amounts employees have earned but have not yet been paid, current workers' compensation, unemployment costs, health benefits, and the current portion of the amounts payable for retirement benefits.

Deferred Retirement Benefits and Costs

This is the present value of our estimated legal obligation to the Civil Service Retirement and Disability Fund for the amount of retirement benefits payable in the future for our current employees' retirement and our present retirees and their survivors. The present value of our benefits payable for our current employees increases when management increases basic pay. The present value of our benefits payable also increases when cost of living adjustments (COLAs) are granted to our retirees or their survivors. We capitalize as deferred retirement costs the amounts due and payable in future years. We expense and pay these costs over periods of 30 years for amounts attributable to current employees and 15 years for amounts attributable to retirees, at 5% interest. We account for our participation in the U.S. government sponsored retirement plans as participation in a multi-employer plan arrangement.

Post-Retirement Health Benefits

Retiree health benefits costs are our obligation to pay a portion of the health insurance premiums of those retirees and their survivors who participate in the Federal Employees Health Benefits Program (FEHBP). We account for our participation in FEHBP as participation in a multi-employer plan arrangement. Therefore, we expense the costs of our retiree health benefits as we incur them.

Workers' Compensation Costs

We are self-insured for workers' compensation costs under a program administered by the Department of Labor (DOL). We record these costs, which include the employees' medical expenses and payment for continuation of wages, as an operating expense. At the end of the year, our liability represents the estimated present value of the total amounts we expect to pay in the future for postal workers injured through the end of fiscal year 2000. We base our estimate of the total costs of a claim upon the severity of the injury, the age of the injured employee, the assumed life expectancy of the employee, the trend of our experience with such an injury, and other factors. In our calculation of present value, we use a net discount rate of 1.4% for medical expenses and 3.0% for compensation claims.

In fiscal year 1999, we adopted a change in the net discount rate used in determining the present value of estimated future workers' compensation payments for medical claims. The net discount rate for medical claims was changed from 0.1% to 1.4%. The effect of the adoption of this rate has been accounted for as a change in accounting estimate. It resulted in a decrease of $131 million in the fiscal year 1999 compensation and benefits expense. In management's opinion, this net discount rate better reflects the excess of rates of return on government debt instruments of comparable terms relative to expected future medical inflation.

In fiscal year 2000, we refined our methodology used to estimate the present value of the total amounts we expect to pay for current Postal Service workers' compensation claims. The major refinement is the use of a life table that reflects long-term experience with a disabled population to estimate mortality rates of our permanently disabled population. Previously, we had used a life table that reflected experience with the general United States population. In management's opinion, the refinements result in a better estimation of our liability for future outlays on behalf of Postal Service workers' compensation claimants. The effect of the refinements was a reduction of $423 million in the fiscal year 2000 compensation and benefits expense.

At the end of 2000, we estimate our total liability for future workers' compensation costs, excluding Post Office Department (POD) liability, at $5,560 million. At the end of 1999, this liability was $5,306 million. In 2000, we recorded $911 million in workers' compensation expense, compared to the $603 million we recorded in 1999 and the $760 million we recorded in 1998. Our liability for future workers' compensation costs for POD claims was $193 million in 2000 and $210 million in 1999. In 2000, we recorded an expense of $14 million, compared to the $11 million we recorded in 1999 and $8 million in 1998.

Research and Development Costs

We record research and development costs as expenses when we incur them. These costs were $42 million in 2000, $67 million in 1999 and $77 million in 1998.

Advertising

We record advertising costs as expenses when we incur them. These costs were $151 million in 2000, $241 million in 1999 and $301 million in 1998.

Reclassification of Prior Years' Amounts

Certain prior years' amounts have been reclassified to conform to the 2000 presentation.

3 Post-Retirement Health Benefit Programs

Employees of the Postal Service who participate in the Federal Employees Health Benefits Program (FEHBP) for at least the five years immediately before their retirement may participate in the FEHBP during their retirement. Under the FEHBP, we pay a portion of the health insurance premiums of participating retirees and their survivors. This program is administered by the Office of Personnel Management.

The Omnibus Budget Reconciliation Act of 1990 requires us to pay the employer's share of health insurance premiums for all employees, and their survivors, who participate in the FEHBP and who retire on or after July 1, 1971. However, we do not include the costs attributable to Federal civilian service before that date. Our FEHBP costs amounted to $744 million in 2000, $593 million in 1999 and $581 million in 1998. We include these costs in our compensation and benefits expense.

4 Impaired Assets

In 1997, we began to record losses on long-lived assets when events and circumstances indicate that the assets might be impaired. In accordance with FASB Statement No. 121, "Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to Be Disposed Of," we have written down our impaired assets to the lower of cost or fair value. No material impairments were recorded in 2000, 1999 and 1998.

5 Debt and Related Interest Costs

Under the Postal Reorganization Act, as amended by Public Law 101-227, we can issue debt obligations. However, we are limited to net annual increases of $2 billion in our debt for capital improvements and to $1 billion for operating expenses. Our total debt cannot exceed $15 billion.

Debt is due as follows (dollars in millions):

Year	Amount
2001	$6,814
2002	—
2003	200
2004	—
2005	—
After 2005	2,302

We paid in cash $263 million in interest in 2000, $202 million in interest in 1999 and $236 million in 1998.

The current estimated market value of our debt is $9,316 million in 2000 and $6,877 million in 1999 (Note 2). All notes payable to the Federal Financing Bank (FFB) may be repurchased at current value at any time with five days notice of intent to do so.

The following page details our debt, which consists of Notes Payable to the FFB and Mortgage Notes Payable.

Our Debt Consists of the Following:

(dollars in millions)

Interest Rate %	Terms *	September 30, 2000	1999
Notes payable to the Federal Financing Bank (FFB):			
8.075	Payable $32 million each year to May 31, 2000	$ —	$ 32
7.800	Payable $15 million each year to May 31, 2001	15	30
8.760**	Payable $36 million each year to May 31, 2001	36	72
6.274	Payable May 16, 2005	—	500
6.350***	Overnight revolving credit facility; final maturity date October 2, 2000	262	279
5.084	Payable March 30, 2000	—	500
4.977	Payable March 31, 2034; repurchasable at par December 31, 1999 and every March 31, June 30, September 30, and December 31 thereafter	—	750
6.323****	Short-term revolving credit facility; final maturity date October 2, 2000	3,400	2,500
6.323	Payable August 31, 2001; repurchasable at par November 30, 2000; February 28, and May 31, 2001	1,000	—
6.323	Payable December 28, 2000	800	—
6.333	Payable March 1, 2001	500	—
6.183	Payable May 31, 2001	800	—
5.568	Payable December 31, 2002	200	200
5.688	Payable August 15, 2007	400	400
5.546	Payable August 15, 2007	150	150
5.959	Payable November 15, 2027	400	400
5.726	Payable November 15, 2027	100	100
5.606	Payable November 15, 2027	300	300
5.426	Payable May 15, 2008	200	200
4.981	Payable May 15, 2008	200	200
4.910	Payable May 15, 2008	200	200
4.836	Payable November 15, 2027	100	100
6.299	Payable May 15, 2030	250	—
		9,313	6,913
Mortgage Notes Payable:			
5.00 to 9.25	Maturing from fiscal years 2001 through 2039 secured by land, buildings and equipment with a carrying amount of $31 million.	3	4
		9,316	6,917
Less current portion of debt		6,814	3,363
		$2,502	$3,554

* All debt is repurchasable at any time at a price determined by then current FFB rates.
** Weighted average interest rate; prior year's weighted average interest rate was 8.761%.
*** Prior year rate was 5.002%.
**** Prior year rate was 4.971%.

6 Retirement Programs

With certain exceptions, employees participate in one of the following three retirement programs based upon the starting date of their employment with the Postal Service. Employee and employer contributions are made to the Civil Service Retirement and Disability Fund (CSRDF), which is administered by the Office of Personnel Management. Employees may also participate in the Thrift Savings Plan, which is a defined contribution retirement savings and investment plan. Postal Service employees are authorized to participate in the Thrift Savings Plan by the Federal Employees Retirement System Act of 1986. The Plan is administered by the Federal Retirement Thrift Investment Board.

Civil Service Retirement System (CSRS)

Under the Postal Reorganization Act, officers and career employees are covered by the Civil Service Retirement System, which provides a basic annuity and Medicare coverage. The CSRS fund covers substantially all employees hired prior to January 1, 1984. Effective January 1, 2000, participating employees contribute 7.4% of their basic pay to the CSRDF. Effective January 1, 1999, participating employees contributed 7.25% of their basic pay. Prior to January 1, 1999, participating employees contributed 7% of their basic pay. We contribute an amount equal to 7% of each employee's basic pay to the CSRDF. We and the employee also contribute to Medicare at the rate prescribed by law. We do not match contributions to the Thrift Savings Plan for employees who participate in the CSRS.

Dual Civil Service Retirement System (Dual CSRS)/Social Security System

Employees with prior U.S. government service who were hired between January 1, 1984 and January 1, 1987 are covered by the Dual Civil Service Retirement System/Social Security System. We contribute 7% of the employee's basic pay to the CSRDF. Effective January 1, 2000, participating employees contribute 1.20% of their basic pay. Effective January 1, 1999, participating employees contributed 1.05% of their basic pay. Prior to January 1, 1999, participating employees contributed 0.8% of their basic pay. We and the employee also contribute to Social Security and Medicare at the rates prescribed by law. We do not match contributions to the Thrift Savings Plan for employees who participate in the Dual System.

Federal Employees Retirement System (FERS)

Effective January 1, 1987, officers and career employees hired since December 31, 1983, except for those covered by the Dual System, are covered by the Federal Employees Retirement System Act of 1986. In addition, employees hired before January 1, 1984 could choose during certain periods in 1987, 1988 and 1998 to participate in the FERS. This System consists of Social Security, a basic annuity plan, and a Thrift Savings Plan.

We contributed to the basic annuity plan 10.7% of each employee's basic pay in 2000, 1999 and 1998. Effective January 1, 2000, participating employees contribute 1.20% of their basic pay. Effective January 1, 1999, participating employees contributed 1.05% of their basic pay. Prior to January 1, 1999, participating employees contributed 0.8% of their basic pay. We and the employee also contribute to Social Security and Medicare at the rates prescribed by law. In addition, we are required to contribute to the Thrift Savings Plan a minimum of 1% per year of the basic pay of employees covered by this System. We also match a voluntary employee contribution up to 3% of the employee's basic pay, and 50% of a contribution between 3 and 5% of basic pay.

The number of employees enrolled in each of the retirement plans at the end of 2000, 1999 and 1998 is as follows:

	2000	1999*	1998
CSRS	263,383	281,062	298,827
Dual CSRS/ Social Security	12,021	12,598	13,418
FERS	510,509	503,233	479,069

*** From July 1998 to December 1998 workers covered by CSRS were allowed to switch to FERS. During this period only 3,436, or less than 1.2%, of our employees chose to change plans.**

Deferred Retirement Costs

Deferred retirement costs consist of the following (dollars in millions):

	2000	1999
CSRS basic pay increases	$25,857	$25,545
CSRS retirees' and survivors' cost of living adjustments	6,326	5,952
Total	$32,183	$31,497

There are no deferred retirement costs associated with FERS.

Deferred Retirement Liability–Civil Service Retirement System

When we increase CSRS employees' current basic pay, we are liable for the additional deferred retirement liability. The Office of Personnel Management determines the estimated increase in our deferred liability. We amortize and pay this amount in 30 equal annual installments, which includes interest computed at a rate of 5% per year. We make the first payment at the end of the year in which employees receive their pay increase.

The increase in our deferred liability for retirement benefits under the CSRS as a result of basic pay increases was $1,635 million in 2000, $930 million in 1999 and $836 million in 1998.

Deferred Retirement Liability–Retirees' and their Survivors' Cost of Living Adjustments (COLAs)

Congress determines the COLAs granted to our retirees. Under the Omnibus Budget Reconciliation Act of 1990, we are liable for our share of the cost of living adjustments granted to those retirees, and their survivors, retiring on or after July 1, 1971. We are not responsible for any costs due to Federal civilian service before that date.

Each year the Office of Personnel Management determines the estimated increase in our liability under this law for the current year. We amortize and pay each year's amount in 15 equal annual installments, which include interest computed at a rate of 5% per year.

The increase in our deferred liability for our retirees' COLAs was $1,056 million in 2000, $537 million in 1999 and $790 million in 1998.

Future Minimum Payments

We estimate the future minimum payments we have to make in order to fund CSRS benefits and retirees cost of living adjustments as of September 30, 2000, are as follows (dollars in millions):

Year	Amount
2001	$ 3,580
2002	3,508
2003	3,429
2004	3,308
2005	3,218
After 2005	31,630
	48,673
Less amount representing interest	16,485
Total future minimum payments	32,188
Less: Portion classified as a current liability in compensation and benefits	1,976
Long-term portion of future minimum payments	$30,212

Expense Components

Listed below are the components of our total retirement expenses that are included in our compensation and benefits expense and related interest expense in the Statement of Operations for 2000, 1999 and 1998 (dollars in millions):

	2000	1999	1998
CSRS	$ 800	$ 816	$ 849
FERS	1,944	1,824	1,640
FERS—Thrift Savings Plan	750	681	608
Dual CSRS/ Social Security	35	35	36
Social Security	1,427	1,337	1,241
Amortization of deferred cost:			
CSRS	1,322	1,214	1,142
Annuitant COLAs	683	602	569
Interest expense on deferred liabilities	1,568	1,592	1,613
Total retirement expense	$8,529	$8,101	$7,698

Employer cash contributions to retirement plans were $7,084 million in 2000, $6,756 million in 1999, and $6,647 million in 1998. These amounts do not include Social Security and Medicare contributions.

7 Revenue Forgone

Our operating revenue includes accruals for revenue forgone. Revenue is forgone when Congress mandates that we provide free or reduced mail rates for certain mailers. The difference between the price Congress has mandated and the price we would have charged the mailer determines the amount of forgone revenue. Congress appropriates money to reimburse us for only a portion of the revenue forgone that we have incurred in past years. In our operating revenue, we have included as revenue the amounts appropriated by Congress for revenue forgone of $64 million for 2000, $71 million for 1999, and $67 million for 1998. Legislation that was passed during 2000 appropriated the $64 mllion for 2000 but delayed the payment until fiscal year 2001. Accordingly, we have recorded this as a receivable.

Under the Revenue Forgone Reform Act of 1993, Congress is required to reimburse us $29 million annually through 2035 (42 years). This reimbursement is for two purposes: services we performed in 1991, 1992 and 1993 for which we have not yet been paid; and for shortfalls in the reimbursement for the costs we incurred for processing and delivering certain nonprofit mail from 1994 through 1998.

The Revenue Forgone Reform Act of 1993 authorized a total of $1.218 billion in payments. We calculated the present value of these future reimbursements to be approximately $390 million at 7% interest. We recognized the $390 million as revenue during fiscal years 1991 through 1998. The amounts receivable as of September 30, 2000 and 1999 were $375 million and $378 million, respectively. We recognized no revenue in 2000 and 1999 and $10 million in 1998.

8 Commitments

At September 30, 2000, we estimate our financial commitment for approved Postal Service capital projects in progress to be approximately $3,641 million.

In addition, we are in negotiations for the buyout of certain assets and leases associated with the processing and transportation of Priority Mail.

Our total rental expense for the years ended September 30 is summarized as follows (dollars in millions):

	2000	1999	1998
Non-cancelable real estate leases including related taxes	$ 806	$ 766	$711
Facilities leased from General Services Administration subject to 120-day notice of cancellation	39	36	37
Equipment and other short-term rentals	254	431	234
Total	$1,099	$1,233	$982

At September 30, 2000, our future minimum lease payments for all non-cancelable leases are as follows (dollars in millions):

Year	Operating	Capital
2001	$ 755	$ 83
2002	722	83
2003	682	83
2004	643	83
2005	593	83
After 2005	5,641	531
	$9,036	$946
Less: Interest at 6.5%		279
Total capital lease obligations		667
Less: Short-term portion of capital lease obligations		41
Long-term portion of capital lease obligations		$626

Most of these leases contain renewal options for periods ranging from 3 to 20 years. Certain non-cancelable real estate leases give us the option to purchase the facilities at prices specified in the leases.

Capital leases included in buildings were $772 million in 2000 and $663 million in 1999. Total accumulated amortization is $161 million in 2000 and $122 million in 1999. Amortization expense for assets recorded under capital leases is included in depreciation expense.

9 Contingent Liabilities

Each quarter we review litigation pending against us. As a result of this review, we classify and adjust our contingencies for claims that we think it is probable that we will lose and for which we can reasonably estimate the amount of the unfavorable outcome. These claims cover labor, equal employment opportunity, environmental issues, traffic accidents, injuries on postal properties, personal claims and property damages, and suits and claims arising from postal contracts. We also recognize the settlements of claims and lawsuits and revisions of other estimates. Additionally, we evaluate the materiality of cases determined to have a reasonably possible chance of adverse outcome. Such cases are immaterial to our financial statements taken a whole.

As a part of our continuing evaluation of estimates required in the preparation of our financial statements, we recorded approximately a $63 million increase in liabilities in 2000 to recognize changes in the estimated cost of litigation and claims asserted prior to 2000. We recognized settlements of claims and lawsuits and revised other estimates in our changes in contingent liabilities. Management and General Counsel believe that we have made adequate provision for the amounts that may become due under the suits, claims, and proceedings we have discussed here.

Report of Independent Auditors

Board of Governors
United States Postal Service

We have audited the accompanying balance sheets of the United States Postal Service as of September 30, 2000 and 1999, and the related statements of operations, changes in net capital deficiency and cash flows for each of the three years in the period ended September 30, 2000. These financial statements are the responsibility of the United States Postal Service's management. Our responsibility is to express an opinion on these financial statements based on our audits.

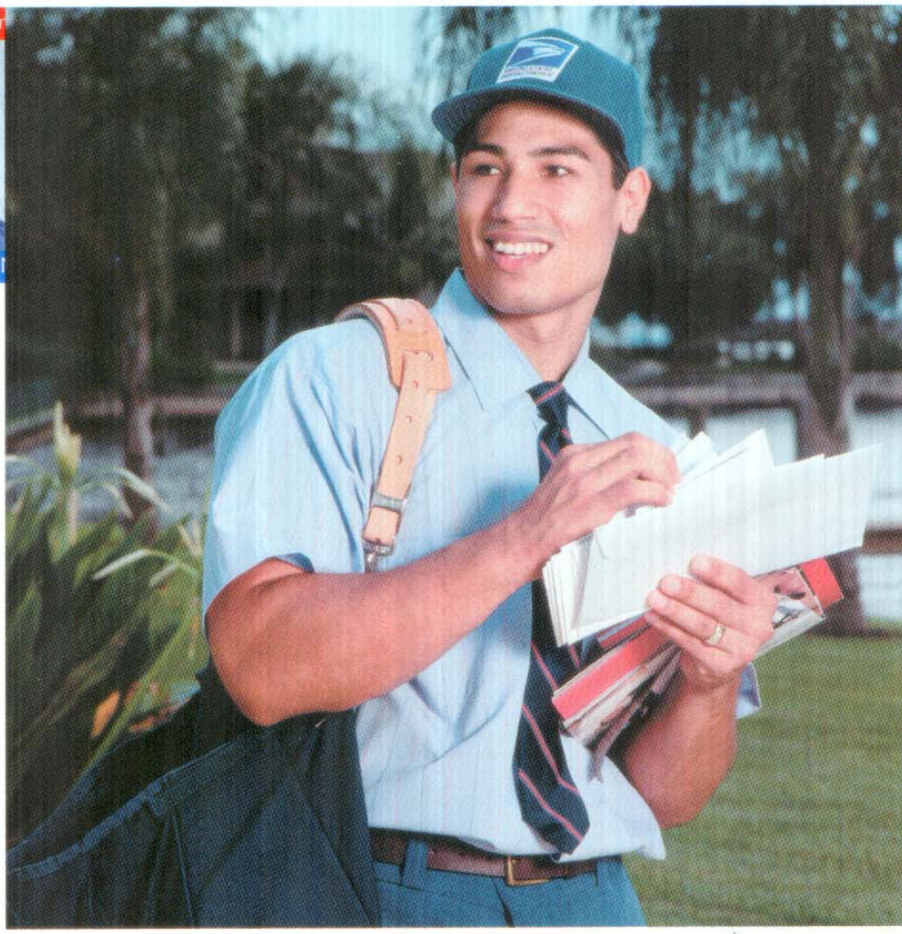
We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards for financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

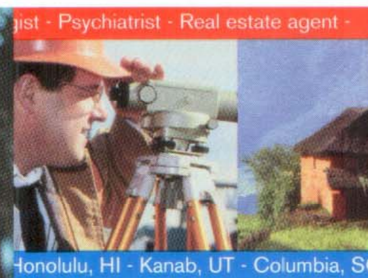
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the United States Postal Service at September 30, 2000 and 1999, and the results of its operations and its cash flows for each of the three years in the period ended September 30, 2000, in conformity with accounting principles generally accepted in the United States.

In accordance with *Government Auditing Standards*, we have issued our report dated November 10, 2000 on our consideration of the United States Postal Service's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report when considering the results of our audit.

Ernst & Young LLP

Washington, D.C.
November 10, 2000





Financial History Summary

	2000	1999*	1998*
Statements of Operations			
(dollars in billions)			
Total revenue	$ 64.6	$ 62.7	$ 60.1
Total expense	64.8	62.4	59.5
Net (loss) income	$ (0.2)	$ 0.4	$ 0.6
(dollars in millions)			
Operating revenue	$ 64,476	$62,655	$60,005
Revenue forgone appropriation	64	71	67
Total operating revenue	64,540	62,726	60,072
Compensation and benefits	49,532	47,333	45,596
Restructuring costs	—	—	—
Other expenses	13,460	13,309	12,190
Total operating expenses	62,992	60,642	57,786
Income from operations	1,548	2,084	2,286
Interest and investment income	41	29	44
Interest expense on deferred retirement liabilities	(1,568)	(1,592)	(1,613)
Interest expense on borrowings	(220)	(158)	(167)
Income (loss) before retroactive assessments and extraordinary items	(199)	363	550
Retroactive assessments for employee benefits**	—	—	—
Income (loss) before extraordinary item	(199)	363	550
Extraordinary item—debt refinancing premium	—	—	—
Net (loss) income	$ (199)	$ 363	$ 550
Balance Sheets			
Assets			
Current assets	$ 1,655	1,296	$ 1,893
Property and equipment, deferred retirement costs and other assets	56,628	54,713	53,015
Total assets	$58,283	$56,009	$54,908
Liabilities			
Current liabilities	$18,277	$15,436	$15,278
Other liabilities	38,150	37,466	37,652
Long-term debt	2,502	3,554	2,788
(Net capital deficiency)/equity	(646)	(447)	(810)
Total liabilities and (net capital deficiency)/equity	$58,283	$56,009	$54,908
Changes in (Net Capital Deficiency)/Equity			
Beginning balances			
Capital contributions of the U.S. government	$ 3,034	$ 3,034	$ 3,034
Deficit since reorganization	(3,481)	(3,844)	(4,394)
Total beginning balance (net capital deficiency)/equity	(447)	(810)	(1,360)
Net (loss) income	(199)	363	550
Ending balance***	$ (646)	$ (447)	$ (810)

* Certain reclassifications have been made to previously reported amounts.
** Relates to OBRA 1990 and 1993.
*** Some totals may not add exactly due to rounding.

97*	1996*	1995*	1994*	1993*	1992*	1991*	1990*
8.3	$ 56.6	$ 54.5	$ 49.6	$ 48.0	$ 47.1	$ 44.2	$ 40.1
7.0	55.0	52.7	50.5	49.8	47.6	45.7	41.0
1.3	$ 1.6	$ 1.8	$ (0.9)	$ (1.8)	$ (0.5)	$ (1.5)	$ (0.9)
133	$56,309	$54,176	$49,252	$47,418	$46,151	$43,323	$39,202
83	93	117	131	164	545	562	453
216	56,402	54,293	49,383	47,582	46,696	43,885	39,655
835	42,676	41,931	39,609	38,448	37,122	34,904	33,158
—	—	—	—	129	1,010	—	—
038	10,437	8,799	8,846	7,745	7,521	7,215	6,276
873	53,113	50,730	48,455	46,322	45,653	42,119	39,434
343	3,289	3,563	928	1,260	1,043	1,766	221
115	142	216	193	404	409	318	419
629)	(1,496)	(1,443)	(1,433)	(1,416)	(1,350)	(1,263)	(1,056)
307)	(368)	(566)	(601)	(620)	(638)	(480)	(458)
264	1,567	1,770	(913)	(372)	(536)	341	(874)
—	—	—	—	(857)	—	(1,810)	—
264	1,567	1,770	(913)	(1,229)	(536)	(1,469)	(874)
—	—	—	—	(536)	—	—	—
264	$ 1,567	$ 1,770	$ (913)	$ (1,765)	$ (536)	$ (1,469)	$ (874)
736	$ 1,670	$ 2,975	$ 2,683	$ 4,478	$ 6,027	$ 4,863	$ 4,528
675	50,157	46,146	43,733	42,803	41,638	38,403	32,977
411	$51,827	$49,121	$46,416	$47,281	$47,665	$43,266	$37,505
107	$12,796	$11,499	$11,665	$10,140	$ 9,484	$ 7,400	$ 6,290
439	37,746	34,794	32,985	33,503	32,291	30,474	25,825
225	3,909	7,019	7,727	8,686	9,173	8,139	6,668
360)	(2,624)	(4,191)	(5,961)	(5,048)	(3,283)	(2,747)	(1,278)
411	$51,827	$49,121	$46,416	$47,281	$47,665	$43,266	$37,505
034	$ 3,034	$ 3,034	$ 3,034	$ 3,034	$ 3,035	$ 3,034	$ 3,034
658)	(7,225)	(8,995)	(8,082)	(6,318)	(5,781)	(4,312)	(3,438)
624)	(4,191)	(5,961)	(5,048)	(3,283)	(2,747)	(1,278)	(402)
264	1,567	1,770	(913)	(1,765)	(536)	(1,469)	(874)
360)	$ (2,624)	$ (4,191)	$ (5,961)	$ (5,048)	$ (3,283)	$ (2,747)	$ (1,278)

Operating Statistics

(in millions of units indicated)

Class of Mail	2000	1999*	1998	1997	1996
First-Class Mail					
Pieces, number	103,525.7	101,936.5	100,434.2	99,659.9	98,216.1
Weight, pounds	4,392.0	4,299.9	4,151.3	4,115.1	4,019.5
Revenue	$ 35,515.9	$ 34,933.2	$ 33,861.2	$ 33,397.6	$ 33,116.5
Priority Mail					
Pieces, number	1,222.5	1,189.5	1,174.4	1,068.2	937.3
Weight, pounds	2,352.3	2,142.6	1,980.0	1,860.6	1,562.8
Revenue	$ 4,837.1	$ 4,533.3	$ 4,187.4	$ 3,856.9	$ 3,321.5
Express Mail					
Pieces, number	70.9	68.7	66.2	63.6	57.6
Weight, pounds	80.0	78.3	77.7	76.3	63.7
Revenue	$ 996.1	$ 942.0	$ 854.5	$ 824.7	$ 736.8
Mailgrams					
Pieces, number	3.7	4.1	4.3	5.3	4.2
Revenue	$ 1.5	$ 1.6	$ 1.7	$ 2.0	$ 1.6
Periodicals					
Pieces, number	10,364.8	10,273.8	10,316.8	10,411.4	10,126.2
Weight, pounds	4,720.3	4,482.6	4,451.1	4,338.3	4,132.0
Revenue	$ 2,170.7	$ 2,115.3	$ 2,072.3	$ 2,067.5	$ 2,013.9
Standard Mail (A)					
Pieces, number	90,057.1	85,661.7	82,508.1	77,253.6	71,686.1
Weight, pounds	11,142.6	10,648.3	10,376.8	9,693.9	9,014.4
Revenue	$ 15,193.3	$ 14,435.8	$ 13,701.7	$ 12,876.0	$ 12,175.1
Standard Mail (B)					
Pieces, number	1,128.4	1,043.1	1,023.4	988.4	948.9
Weight, pounds	3,773.8	3,533.2	3,407.3	2,889.9	2,696.6
Revenue	$ 1,912.3	$ 1,828.5	$ 1,754.3	$ 1,627.6	$ 1,524.1
International Surface					
Pieces, number	78.7	103.2	95.6	97.4	104.5
Weight, pounds	89.4	96.1	95.6	102.0	106.5
Revenue	$ 180.3	$ 193.9	$ 183.7	$ 192.0	$ 198.9
International Air					
Pieces, number	1,020.7	927.5	848.4	909.5	948.6
Weight, pounds	169.7	152.2	149.0	157.2	147.0
Revenue**	$ 1,477.2	$ 1,434.2	$ 1,416.1	$ 1,422.8	$ 1,449.9
U.S. Postal Service					
Pieces, number	362.9	382.3	380.1	377.3	360.1
Weight, pounds	95.3	102.6	96.2	88.4	97.8
Free Mail for the Blind and Handicapped					
Pieces, number	46.6	53.2	53.2	53.3	50.0
Weight, pounds	25.1	26.6	27.2	30.6	32.6
TOTALS* **					
Pieces, number	207,882.2	201,643.5	196,904.7	190,888.1	183,439.5
Weight, pounds	26,840.6	25,562.2	24,812.3	23,352.4	21,873.0
Revenue	$ 62,284.3	$ 60,417.8	$ 58,032.9	$ 56,267.0	$ 54,538.2

* Certain reclassifications have been made to previously reported international amounts.
** Includes foreign postal transaction revenue.
*** Agency and franked mail are included in their classes of mail, when using official mail.
Some totals may not add exactly due to rounding.

(in millions of units indicated)

Class of Mail	2000	1999	1998	1997	1996
Registered*					
Number of articles	13.3	13.7	15.3	16.3	18.6
Revenue	$ 98.4	$ 95.2	$ 89.2	$ 95.2	$ 113.3
Certified*					
Number of articles	270.5	268.1	278.3	284.5	270.8
Revenue	$ 385.4	$ 377.3	$ 385.7	$ 342.8	$ 558.5
Insurance*					
Number of articles	58.0	48.6	40.8	33.7	28.7
Revenue	$ 108.9	$ 91.5	$ 72.5	$ 61.0	$ 49.2
Delivery Receipt Services**					
Number of articles	356.9	249.3	237.3	260.5	-
Revenue	$ 316.8	$ 284.7	$ 262.1	$ 289.4	-
Collect on Delivery					
Number of articles	4.1	4.0	3.8	4.7	4.9
Revenue	$ 21.5	$ 19.8	$ 17.8	$ 21.8	$ 21.3
Special Delivery					
Number of articles	0.0	—	—	0.1	0.4
Revenue	$ 0.0	$ —	$ —	$ 1.4	$ 3.8
Money Orders					
Number issued	232.8	220.9	208.6	206.1	214.0
Revenue	$ 234.7	$ 228.3	$ 210.1	$ 212.2	$ 221.3
Face value of issues (non-add)***	$29,945.2	$28,491.4	$26,724.6	$26,180.4	$25,355.6
Other					
Box rent revenue	$ 684.2	$ 667.2	$ 617.4	$ 577.6	$ 570.3
Stamped envelope and card revenue	$ 15.4	$ 30.7	$ 17.4	$ 17.1	$ 15.9
Other revenue, net	$ 326.0	$ 442.0	$ 299.8	$ 247.0	$ 217.2
TOTALS					
Special Services revenue	$ 2,191.2	$ 2,236.7	$ 1,972.1	$ 1,865.6	$ 1,770.8
Mail revenue	$62,284.3	$60,417.8	$58,032.9	$56,267.0	$54,538.2
Operating revenue before appropriations	$64,475.6	$62,654.5	$60,005.0	$58,132.6	$56,309.0

* Return receipts have been broken out from registered, certified and insurance special service categories.

** Delivery Receipt Services contains Return Receipts, Return Receipts for Merchandise and Delivery Confirmation. Delivery Confirmation Service began during 1999.

*** Certain reclassifications have been made to previously reported amounts.

Operating Statistics

	2000	1999	1998	1997	1996
Headquarters and Related Employees*					
Headquarters	2,279	2,372	2,231	1,949	1,951
Headquarters—Field Support Units	5,566	4,357	4,307	4,319	4,023
Inspection Service (field)	4,190	4,334	4,280	4,347	4,432
Inspector General	664	387	223	101	—
Subtotal	12,699	11,450	11,041	10,716	10,406
Field Career Employees*					
Area Offices	1,597	1,875	1,703	1,566	1,541
Postmasters/Installation Heads	26,121	26,108	26,156	26,256	26,489
Supervisors/Managers	38,797	38,835	36,508	35,708	35,282
Prof. Admin. Tech. Personnel	9,959	11,097	11,703	11,369	11,035
Clerks	281,956	292,400	293,829	280,818	276,964
Nurses	191	188	189	193	188
Mail Handlers	60,851	62,237	62,247	59,147	58,305
City Delivery Carriers	241,079	242,300	240,813	234,033	238,370
Motor Vehicles Operators	9,347	9,270	9,026	8,625	8,429
Rural Delivery Carriers—Full Time	57,111	54,588	52,241	49,957	48,340
Special Delivery Messengers	—	—	7	1,331	1,463
Bldg. & Equip. Maintenance Personnel	42,284	41,873	41,054	39,954	39,272
Vehicle Maintenance Personnel	5,546	5,574	5,524	5,501	4,882
Subtotal	774,839	786,345	781,000	754,458	750,560
Total Career Employees	787,538	797,795	792,041	765,174	760,966
Non-Career Employees*					
Casuals	29,572	25,067	25,711	32,615	24,696
Non-Bargaining Temporary	712	707	784	774	654
Rural Subs/RCA/RCR/AUX	57,532	57,357	56,265	54,834	53,768
PM Relief/Leave Replacements	12,423	12,485	12,613	12,687	12,724
Transitional Employees	13,461	12,355	17,222	26,789	33,066
Offices, Stations and Branches					
Number of post offices	27,876	27,893	27,952	28,060	28,189
Number of stations and branches:					
Classified stations and branches	5,802	5,788	5,661	5,446	5,521
Contract stations and branches	2,833	2,903	2,974	2,907	2,897
Community post offices	1,549	1,585	1,572	1,606	1,605
Subtotal	10,184	10,276	10,207	9,959	10,023
TOTAL OFFICES, STATIONS AND BRANCHES	38,060	38,169	38,159	38,019	38,212

* Complement data uses On-Rolls and Paid Employees Statistics database.

Glossary

Accruals: Revenue and expenses that are recorded as they occur, even though they may not have actually been paid.

Amortize: To reduce the value of an asset through regular charges to income over time; or to write off expenditures by prorating them over a period of time.

Appropriation: Public funds set aside by Congress for a specific purpose.

Bar code: A series of vertical full bars and half bars representing the ZIP Code information printed on a mailpiece to facilitate automated processing by barcode reader equipment.

Callable: Debt that the Postal Service as the borrower has the right to repurchase.

Capitalize: To treat an expenditure as an asset; or to compute the present value of a future payment that will be paid over a period of time.

Contribution: The difference between the revenue from a class of mail and that class's volume-variable costs. For example, if a class of mail has revenues of $1.5 billion and volume-variable costs of $1 billion, its contribution is $500 million, which means that this class of mail covers its costs and contributes $500 million to the common costs of all mail services.

CustomerPerfect!: A quality process management system that builds customer satisfaction and excellence into every process and procedure of the Postal Service.

Delivery Confirmation: Delivery Confirmation is a special service designed to provide the date of delivery or attempted delivery for Priority Mail and Standard Mail (B)—parcels, bound printed matter and library mail.

Depreciate: To periodically reduce the estimated value of an asset over the course of its useful life.

Deputy Postmaster General (DPMG): A member of the Board of Governors, jointly appointed by the Postmaster General and Governors.

Economic Value Added (EVA): A measure of financial performance calculated by taking net operating income and subtracting a charge for the capital used to produce that income (EVA = net operating income – capital charge).

Equity: The difference between the value of all assets less all liabilities.

Express Mail: The Postal Service's premium delivery service, providing guaranteed overnight delivery for documents and packages weighing up to 70 pounds. Both domestic and international services are offered.

First-Class Mail: A class of mail including letters, postcards, and postal cards, all matter wholly or partially in writing or typewriting, and all matter sealed or otherwise closed against inspection.

Fixed Asset: Any tangible property such as buildings, machinery and equipment, furniture, and leasehold improvements.

Generally Accepted Accounting Principles (GAAP): The rules and procedures of accepted accounting practice as defined by the Financial Accounting Standards Board.

Global Package Link (GPL): International package delivery service and state-of-the-art information system for volume mailers sending merchandise to participating overseas markets.

Global Priority Mail (GPM): A category of international mail that provides fast service at attractive rates to 27 countries.

Gross Domestic Product (GDP): The total market value of all the goods and services produced in one year in the United States.

Inspector General: The Inspector General is appointed by and reports directly to the Governors of the Postal Service and is independent of postal management. The Office of Inspector General (OIG) primarily investigates and evaluates programs and operations of the Postal Service to ensure the efficiency and integrity of the postal system.

Leasehold: An asset that gives the Postal Service the right to use property under a lease.

Liability: Any debt or obligation the Postal Service is bound to pay.

Negative Equity: The amount of money that the Postal Service does not have to settle all of its obligations if they were to come due immediately.

Parcel Select: A product offering workshare discounts for volume shippers.

PC Postage: Products approved by the Postal Service for development and distribution by commercial vendors. Postage is purchased and printed using personal computers and the Internet.

Periodicals: A class of mail, formerly called second-class mail, that consists of magazines, newspapers, and other publications.

Point-of-Service ONE (POS ONE): An electronic retail sales device that assists employees with retail transactions and provides product inventory and sales information.

Postal Inspection Service: The investigative arm of the Postal Service responsible for investigating criminal acts involving the mails and misuse of the postal system.

Postal Rate Commission (PRC): An independent federal agency that makes recommendations concerning Postal Service requests for changes in postal rates and mail classifications.

Postmaster General (PMG): The chief executive officer of the Postal Service, appointed by and serving at the pleasure of the Governors.

Present Value: The value today of a future payment that is discounted at a stated rate of compound interest. For example, the present value of $100 that will be paid to the Postal Service 10 years from now is about $38.55, if we discount that $100 at a rate equal to 10 percent interest compounded annually.

Priority Mail: Priority Mail provides two- to three-day delivery service.

Priority Mail Global Guaranteed: An alliance with DHL Worldwide Express, Inc. providing day-certain delivery guaranteed service to 65 countries around the world.

Processing and Distribution Center (P&DC): A large mail-sorting and dispatching plant that serves as a hub for mail originating from post offices, collection boxes and customer mailboxes, and large-volume mailers in a designated service area.

Receivable: Money that is owed to the Postal Service.

Recognize: To record in Postal Service accounts as income or expense.

Returns@ease: A set of merchandise return options that makes returning items bought online, through catalogs, and by phone easier for buyers and participating retailers.

Standard Mail: New name for the merger of third-class mail and fourth-class mail as one class under Classification Reform implementation of July 1, 1996.

U.S. Mail: Any mailable matter that is accepted for mail processing and delivery by the Postal Service.

United States Postal Service (USPS): The successor to the Post Office Department, the USPS was established by the Postal Reorganization Act of July 1, 1971, as an independent, self-supporting federal agency within the executive branch.

Universal Service: The Postal Service's mandate and commitment to the nation to provide mail delivery service at uniform and reasonable rates to everyone, everywhere, six days a week.

Year: As used in the financial section of this report, it means the Postal Service fiscal year, which is the 12-month period during which the Postal Service keeps accounts, beginning Oct. 1 and closing Sept. 30.

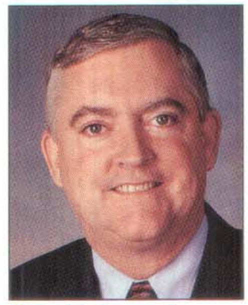
The Leadership of the Postal Service

Management Committee

William J. Henderson
Postmaster General,
Chief Executive Officer

John M. Nolan
Deputy Postmaster General,
Chief Marketing Officer

John E. Potter
Chief Operating Officer
& Executive Vice President



Richard J. Strasser, Jr.
Chief Financial Officer
& Executive Vice President

Deborah K. Willhite
Senior Vice President,
Government Relations
& Public Policy

Karla W. Corcoran
Inspector General

Patrick R. Donahoe
Senior Vice President,
Human Resources

Mary Anne Gibbons
Vice President,
General Counsel

Peter A. Jacobson
Chief Technology Officer
& Senior Vice President

Allen R. Kane
Senior Vice President
New Business

Officers

Stephen M. Kearney
Senior Vice President,
Corporate/Business Development

Gail G. Sonnenberg
Senior Vice President,
Sales

(Vacant)
Senior Vice President,
Operations

Nicholas F. Barranca
Vice President,
Operations Planning

Anita J. Bizzotto
Vice President,
Pricing & Product Design

Charles E. Bravo
Vice President,
Information Platform

William J. Brown
Vice President,
Area Operations (Southeast)

James A. Cohen
Judicial Officer

William J. Dowling
Vice President, Engineering

Jesse Durazo
Vice President,
Area Operations (Pacific)

Patricia M. Gibert
Vice President, Retail Consumer &
Small Business

Danny Jackson
Vice President,
Area Operations (Great Lakes)

Azeezaly S. Jaffer
Vice President, Public Affairs
& Communications

John F. Kelly
President,
Expedited/Package Services

Robert G. Krause
Vice President, eCommerce

George L. Lopez
Vice President,
Area Operations (Southwest)

Yvonne D. Maguire
Vice President,
Employee Resource Management

Gary McGurdy
Vice President,
Area Operations (Allegheny)

Suzanne Medvidovich
Vice President,
Area Operations (Midwest)

Benjamin P. Ocasio
Vice President,
Diversity Development

Henry A. Pankey
Vice President,
Area Operations (Mid-Atlantic)

Donna M. Peak
Vice President, Finance, Controller

Don W. Peterson
Vice President, Quality

Michele Purton
Vice President, Finance, Treasurer

John A. Rapp
Vice President, Delivery

Robert A. F. Reisner
Vice President, Strategic Planning

Francia G. Smith
Vice President
& Consumer Advocate

David L. Solomon
Vice President, Area Operations
(New York Metro)

Jon M. Steele
Vice President,
Area Operations (Northeast)

A. Keith Strange
Vice President,
Purchasing & Materials

Rudolph K. Umscheid
Vice President, Facilities

Anthony J. Vegliante
Vice President, Labor Relations

Paul Vogel
Vice President,
Network Operations Management

Craig G. Wade
Vice President,
Area Operations (Western)

James P. Wade
Vice President,
International Business

John H. Ward
Vice President,
Core Business Marketing

John R. Wargo
Vice President,
Strategic Marketing

Kenneth C. Weaver
Chief Postal Inspector

Richard D. Weirich
Vice President,
Information Technologies

(Vacant)
Vice President, Retail Operations